

Horizon Technology Finance Corp  
Form 10-Q  
November 06, 2012

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

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

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012**

**OR**

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

**FOR THE TRANSITION PERIOD FROM** \_\_\_\_\_ **TO** \_\_\_\_\_

**COMMISSION FILE NUMBER: 814-00802**

**HORIZON TECHNOLOGY FINANCE CORPORATION**

*(Exact name of registrant as specified in its charter)*

**DELAWARE** **27-2114934**  
*(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)*

**312 Farmington Avenue**  
**Farmington, CT** **06032**

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

(Address of principal executive offices)

(Zip Code)

**Registrant's telephone number, including area code (860) 676-8654**

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of November 5, 2012, the Registrant had 9,562,956 shares of common stock, \$0.001 par value, outstanding.

**HORIZON TECHNOLOGY FINANCE CORPORATION**

**FORM 10-Q  
TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I</b>	
Item 1. Financial Statements	
Consolidated Statements of Assets and Liabilities as of September 30, 2012 and December 31, 2011 (unaudited)	4
Consolidated Statements of Operations for the three and nine months ended September 30, 2012 and 2011 (unaudited)	5
Consolidated Statements of Changes in Net Assets for the nine months ended September 30, 2012 and 2011 (unaudited)	6
Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 (unaudited)	7
Consolidated Schedules of Investments as of September 30, 2012 and December 31, 2011 (unaudited)	8
Notes to the Consolidated Financial Statements (unaudited)	15
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	28
Item 3. Quantitative And Qualitative Disclosures About Market Risk	37
Item 4. Controls and Procedures	37
<b>PART II</b>	
Item 1. Legal Proceedings	37
Item 1A. Risk Factors	37
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	38
Item 3. Defaults Upon Senior Securities	38
Item 4. Mine Safety Disclosures	38
Item 5. Other Information	38
Item 6. Exhibits	38
Signatures	39
EX-31.1	
EX-31.2	
EX-32.1	
EX-32.2	

## Forward-Looking Statements

This quarterly report on Form 10-Q, including the Management's Discussion and Analysis of Financial Condition and Results of Operations, contains statements that constitute forward-looking statements, which relate to future events or our future performance or financial condition. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about our industry, our beliefs and our assumptions. The forward-looking statements contained in this quarterly report on Form 10-Q involve risks and uncertainties, including statements as to:

- our future operating results, including the performance of our existing loans and warrants;
- the introduction, withdrawal, success and timing of business initiatives and strategies;

changes in political, economic or industry conditions, the interest rate environment or financial and capital markets, which could result in changes in the value of our assets;

- the relative and absolute investment performance and operations of our Advisor;
  - the impact of increased competition;
- the impact of investments we intend to make and future acquisitions and divestitures;
  - the unfavorable resolution of legal proceedings;
- our business prospects and the prospects of our portfolio companies;
- the impact, extent and timing of technological changes and the adequacy of intellectual property protection;
  - our regulatory structure and tax status;
  - the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;

the impact of interest rate volatility on our results, particularly if we use leverage as part of our investment strategy;

- the ability of our portfolio companies to achieve their objective;
- our ability to cause a subsidiary to become a licensed Small Business Investment Company;
- the impact of legislative and regulatory actions and reforms and regulatory supervisory or enforcement actions of government agencies relating to us or our Advisor;
  - our contractual arrangements and relationships with third parties;
  - our ability to access capital and any future financings by us;
- the ability of our Advisor to attract and retain highly talented professionals; and
- the impact of changes to tax legislation and, generally, our tax position.

We use words such as “anticipates,” “believes,” “expects,” “intends,” “seeks” and similar expressions to identify forward-looking statements. Undue influence should not be placed on the forward-looking statements as our actual results could differ materially from those projected in the forward-looking statements for any reason, including the factors in “Risk Factors” in our annual report on Form 10-K for the year ended December 31, 2011 and elsewhere in this quarterly report on Form 10-Q.

We have based the forward-looking statements included in this report on information available to us on the date of this report, and we assume no obligation to update any such forward-looking statements. Although we undertake no obligation to revise or update any forward-looking statements in this quarterly report on Form 10-Q, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we may make directly to you or through reports that we in the future may file with the SEC, including, future reports on Form 10-Q, current reports on Form 8-K and annual reports on Form 10-K.

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Statements of Assets and Liabilities (Unaudited)**  
**(In thousands, except share data)**

	September 30, 2012	December 31, 2011
<b>Assets</b>		
Non-affiliate investments at fair value (cost of \$223,685 and \$180,651, respectively) (Note 4)	\$ 220,909	\$ 178,013
Investment in money market funds	2,366	13,518
Cash	3,288	1,298
Interest receivable	4,066	2,985
Other assets	4,702	1,997
<b>Total assets</b>	<b>\$ 235,331</b>	<b>\$ 197,811</b>
<b>Liabilities</b>		
Borrowings (Note 6)	\$ 76,251	\$ 64,571
Base management fee payable (Note 3)	392	330
Incentive fee payable (Note 3)	742	1,766
Other accrued expenses	1,000	1,260
<b>Total liabilities</b>	<b>78,385</b>	<b>67,927</b>
<b>Net assets</b>		
Preferred stock, par value \$0.001 per share, 1,000,000 shares authorized, zero shares issued and outstanding as of September 30, 2012 and December 31, 2011	—	—
Common stock, par value \$0.001 per share, 100,000,000 shares authorized, 9,562,956 and 7,636,532 shares outstanding as of September 30, 2012 and December 31, 2011, respectively	10	8
Paid-in capital in excess of par	154,343	124,512
Accumulated undistributed net investment income	2,372	4,965
Net unrealized depreciation on investments	(2,776	) (2,659
Net realized gains on investments	2,997	3,058
<b>Total net assets</b>	<b>156,946</b>	<b>129,884</b>
<b>Total liabilities and net assets</b>	<b>\$ 235,331</b>	<b>\$ 197,811</b>
<b>Net asset value per common share</b>	<b>\$ 16.41</b>	<b>\$ 17.01</b>

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Statements of Operations (Unaudited)**  
**(In thousands, except share data)**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Investment income				
Interest income on non-affiliate investments	\$ 6,426	\$ 6,129	\$ 17,803	\$ 16,911
Interest income on money market funds	—	2	—	90
Fee income on non-affiliate investments	193	310	923	870
Total investment income	6,619	6,441	18,726	17,871
Expenses				
Interest expense	1,089	725	2,754	2,093
Base management fee (Note 3)	1,087	1,091	3,042	3,229
Performance based incentive fee (Note 3)	742	561	1,992	2,701
Administrative fee (Note 3)	352	355	854	873
Professional fees	147	489	746	1,034
General and administrative	233	227	758	740
Total expenses	3,650	3,448	10,146	10,670
Net investment income	2,969	2,993	8,580	7,201
Net realized and unrealized gain (loss) on investments				
Net realized (loss) gain on investments	—	(17 )	(61 )	5,544 )
Net unrealized appreciation (depreciation) on investments	677	(217 )	(117 )	(2,535 )
Net realized and unrealized gain (loss) on investments	677	(234 )	(178 )	3,009 )
Net increase in net assets resulting from operations	\$ 3,646	\$ 2,759	\$ 8,402	\$ 10,210
Net investment income per common share	\$ 0.33	\$ 0.39	\$ 1.06	\$ 0.95
Change in net assets per common share	\$ 0.40	\$ 0.36	\$ 1.03	\$ 1.34
Weighted average shares outstanding	9,078,010	7,617,972	8,121,986	7,604,345

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Statements of Changes in Net Assets (Unaudited)**  
**(In thousands, except share data)**

	Common Stock		Paid-In Capital in Excess of Par	Accumulated Undistributed (Distributions in Excess of) Net Investment Income	Net Unrealized Appreciation (Depreciation) on Investments	Net Realized Gains on Investments	Total Net Assets
	Shares	Amount					
Balance at December 31, 2010	7,593,421	\$ 8	\$ 123,836	\$ (143 )	\$ 3,043	\$ 451	\$ 127,195
Net increase in net assets resulting from operations	—	—	—	7,201	(2,535 )	5,544	10,210
Issuance of common stock under dividend reinvestment plan	33,297	—	525	—	—	—	525
Dividends declared	—	—	—	(5,551 )	—	—	(5,551 )
Balance at September 30, 2011	7,626,718	\$ 8	\$ 124,361	\$ 1,507	\$ 508	\$ 5,995	\$ 132,379
Balance at December 31, 2011	7,636,532	\$ 8	\$ 124,512	\$ 4,965	\$ (2,659 )	\$ 3,058	\$ 129,884
Issuance of common stock (net of offering costs) (1)	1,909,000	2	29,543	—	—	—	29,545
Net increase in net assets resulting from operations	—	—	—	8,580	(117 )	(61 )	8,402
Issuance of common stock under dividend reinvestment plan	17,424	—	288	—	—	—	288
Dividends declared	—	—	—	(11,173 )	—	—	(11,173 )
Balance at September 30, 2012	9,562,956	\$ 10	\$ 154,343	\$ 2,372	\$ (2,776 )	\$ 2,997	\$ 156,946

On July 18, 2012, the Company completed a follow-on public offering of 1,909,000 shares (including 249,000 (1) shares of common stock that was issued pursuant to the underwriters' option to purchase additional shares) of its common stock at a public offering price of \$16.20 per share. Total offering costs were \$1.4 million.

See Notes to Consolidated Financial Statements





**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Statements of Cash Flows (Unaudited)**  
**(In thousands)**

	For the Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net increase in net assets resulting from operations	\$ 8,402	\$ 10,210
Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities:		
Amortization of debt issuance costs	286	227
Net realized loss (gain) on investments	61	(5,799 )
Net unrealized depreciation on investments	117	2,535
Purchase of investments	(86,720 )	(78,156 )
Principal payments received on investments	44,186	32,574
Proceeds from sale of investments	38	5,887
Stock received in settlement of fee income	—	(544 )
Changes in assets and liabilities:		
Net decrease in investment in money market funds	11,152	10,296
Increase in interest receivable	(1,081 )	(539 )
Decrease in unearned loan income	(578 )	(331 )
Decrease in other assets	16	247
(Decrease) increase in other accrued expenses	(260 )	226
Increase in base management fee payable	62	2
(Decrease) increase in incentive fee payable	(1,024 )	1,039
Net cash used in operating activities	(25,343 )	(22,126 )
Cash flows from financing activities:		
Proceeds from issuance of senior notes	33,000	—
Debt issuance costs	(3,007 )	(1,207 )
Net decrease in revolving borrowings	(21,320 )	(5,540 )
Proceeds from shares sold, net of offering costs	29,545	—
Dividends paid	(10,885 )	(5,026 )
Net cash provided by (used in) financing activities	27,333	(11,773 )
Net increase (decrease) in cash	1,990	(33,899 )
Cash:		
Beginning of period	1,298	37,689
End of period	\$ 3,288	\$ 3,790
Cash paid for interest	\$ 2,395	\$ 1,738
Supplemental non-cash investing and financing activities:		
Warrant investments received & recorded as unearned loan income	\$ 1,120	\$ 1,129

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Receivables resulting from sales of investments	\$ —	\$ 213	
Decrease in interest rate swap liability	\$ —	\$ (245	)

See Notes to Consolidated Financial Statements

7

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments****September 30, 2012****(In thousands)**

Portfolio Company	Sector	Type of Investment (4)(8)	Interest Rate (5)	Maturity	Principal Amount	Cost of Investments (7)	Fair Value
Debt Investments							
Debt Investments — Life Science — 43.0%							
ACT Biotech Corporation	Biotechnology	Term Loan (1)	13.10%	9/1/2014	\$ 964	\$ 944	\$944
		Term Loan (1)	13.01%	9/1/2014	963	960	960
		Term Loan (1)	13.01%	9/1/2014	1,488	1,470	1,470
Ambit Biosciences Corporation	Biotechnology	Term Loan (1)	12.25%	10/1/2013	2,826	2,810	2,810
Anacor Pharmaceuticals, Inc. (6)	Biotechnology	Term Loan (2)	9.41%	4/1/2015	2,924	2,892	2,892
		Term Loan (2)	9.67%	4/1/2015	2,341	2,305	2,305
		Term Loan (2)	9.47%	4/1/2015	4,000	3,934	3,934
Celsion Corporation (6)	Biotechnology	Term Loan (2)	11.75%	10/1/2015	2,500	2,463	2,463
N30 Pharmaceuticals, LLC	Biotechnology	Term Loan (1)	11.25%	9/1/2014	1,893	1,864	1,864
		Term Loan (2)	11.25%	7/1/2015	2,500	2,441	2,441
Revanche Therapeutics, Inc.	Biotechnology	Convertible Note (1)	8.00%	2/10/2013	70	70	70
Sample6 Technologies, Inc.	Biotechnology	Term Loan (2)	11.00%	1/1/2016	2,500	2,449	2,449
Sunesis Pharmaceuticals, Inc. (6)	Biotechnology	Term Loan (2)	8.95%	10/1/2015	2,000	1,981	1,981
		Term Loan (2)	9.00%	10/1/2015	3,000	2,896	2,896
	Biotechnology		11.00%	8/1/2014	2,372	2,357	2,357

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Supernus Pharmaceuticals, Inc.(6)		Term Loan (2)					
		Term Loan (2)	11.00%	7/1/2015	6,591	6,532	6,532
Tranzyme, Inc. (6)	Biotechnology	Term Loan (2)	10.00%	7/1/2015	7,700	7,655	7,655
Xcovery Holding Company, LLC	Biotechnology	Term Loan (2)	12.50%	8/1/2015	918	914	914
		Term Loan (2)	12.50%	8/1/2015	1,444	1,438	1,438
		Term Loan (2)	12.50%	10/1/2015	250	249	249
Mitralign, Inc.	Medical Device	Term Loan	12.00%	10/1/2015	1,714	1,625	1,625
OraMetrix, Inc.	Medical Device	Term Loan (1)	11.50%	4/1/2014	3,069	3,042	3,042
			10.75%				
		Revolver (2)	(Prime + 7.50%)	12/1/2015	2,000	1,973	1,973
PixelOptics, Inc.	Medical Device	Term Loan (2)	10.75%	11/1/2014	8,816	8,771	8,771
Tengion, Inc. (6)	Medical Device	Term Loan (2)	13.00%	5/1/2014	3,660	3,593	3,401
Total Debt Investments — Life Science						67,628	67,436
Debt Investments — Technology — 45.8%							
Avalanche Technology, Inc.	Semiconductors	Term Loan (2)	10.00%	7/1/2016	4,000	3,861	3,861
Luxtera, Inc.	Semiconductors	Term Loan (3)	10.25%	12/1/15	3,333	3,284	3,284
		Term Loan	10.25%	3/1/2016	1,667	1,639	1,639
Xtera Communications, Inc.	Semiconductors	Term Loan	11.50%	12/1/2014	9,124	9,015	9,015
		Term Loan	11.50%	7/1/2015	2,000	1,966	1,966
Grab Networks, Inc.	Internet and Media	Term Loan (3)	12.00%	1/1/2016	2,500	2,371	2,371
Optaros, Inc.	Internet and Media	Term Loan (2)	11.95%	10/1/2015	2,000	1,972	1,972
		Term Loan	11.95%	3/1/2016	500	494	494
SimpleTuition, Inc.	Internet and Media	Term Loan	11.75%	3/1/2016	5,000	4,891	4,891
IntelePeer, Inc.	Networking	Term Loan (1)	12.33%	10/1/2012	60	60	60
Construction Software Technologies, Inc.	Software	Term Loan (2)	11.75%	12/1/2014	3,651	3,620	3,620
		Term Loan	11.75%	6/1/2014	2,000	1,981	1,981
Courion Corporation	Software	Term Loan (3)	11.45%	10/1/2015	3,500	3,478	3,478
		Term Loan (3)	11.45%	10/1/2015	3,500	3,478	3,478
Netuitive, Inc.	Software		11.75%	1/1/2016	3,000	2,973	2,973

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

		Term Loan (3)					
Recondo Technology, Inc.	Software	Term Loan (2)	11.50%	4/1/2015	2,000	1,965	1,965
			10.50%				
		Revolver (2)	(Prime + 7.25%)	4/1/2015	1,000	965	965
Seapass Solutions, Inc.	Software	Term Loan (2)	11.75%	11/1/2014	4,265	4,227	4,227
StreamBase Systems, Inc.	Software	Term Loan (1)	12.51%	11/1/2013	1,741	1,730	1,730
		Term Loan (1)	12.50%	6/1/2014	646	640	640
		Term Loan (2)	12.50%	2/1/2015	1,500	1,473	1,473
Aquion Energy, Inc.	Power Management	Term Loan (2)	10.25%	3/1/2016	3,333	3,309	3,309
		Term Loan (2)	10.25%	3/1/2016	3,333	3,309	3,309
		Term Loan (2)	10.25%	6/1/2016	3,333	3,306	3,306
Xtreme Power, Inc.	Power Management	Term Loan	10.75%	5/1/2016	6,000	5,849	5,849
Total Debt Investments — Technology						71,856	71,856

See Notes to Consolidated Financial Statements

## Horizon Technology Finance Corporation and Subsidiaries

## Consolidated Schedule of Investments

September 30, 2012 — (Continued)

(In thousands)

Portfolio Company	Sector	Type of Investment (4)(8)	Interest Rate (5)	Maturity	Principal Amount	Cost of Investments (7)	Fair Value
Debt Investments — Cleantech — 25.5%							
Renmatix, Inc.	Alternative Energy	Term Loan (2)	10.25%	2/1/2016	2,500	2,398	2,398
		Term Loan (2)	10.25%	2/1/2016	2,500	2,469	2,469
Semprius, Inc.	Alternative Energy	Term Loan (2)	10.25%	6/1/2016	3,750	3,692	3,692
Cereplast, Inc. (6)	Waste Recycling	Term Loan	12.00%	8/1/2014	2,058	1,923	1,681
		Term Loan	12.00%	8/1/2014	2,208	2,183	1,921
Aurora Algae, Inc.	Energy Efficiency	Term Loan (2)	10.50%	5/1/2015	2,261	2,246	2,246
Enphase Energy, Inc. (6)	Energy Efficiency	Term Loan (1)	12.60%	10/1/2013	3,304	3,284	3,284
		Term Loan	10.75%	4/1/2015	1,703	1,687	1,687
		Term Loan	10.75%	4/1/2015	3,000	2,964	2,964
Satcon Technology Corporation (6)	Energy Efficiency	Term Loan (1)	12.58%	1/1/2014	5,278	5,220	5,220
Solarbridge Technologies, Inc.	Energy Efficiency	Term Loan	11.65%	4/1/2016	7,000	6,805	6,805
Tigo Energy, Inc.	Energy Efficiency	Term Loan (1)	11.00%	8/1/2014	2,767	2,740	2,740
		Revolver (2)	10.75% (Prime + 7.50%)	1/1/2014	3,000	2,953	2,953
Total Debt Investments — Cleantech						40,564	40,060
Debt Investments — Healthcare information and services — 21.1%							
BioScale, Inc.	Diagnostics	Term Loan (1)	11.51%	1/1/2014	3,459	3,439	3,439

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Radisphere National Radiology Group, Inc.	Diagnostics		Revolver (2)	11.25% (Prime + 8.00%)	10/1/2015	15,000	14,843	14,843	
Aperio Technologies, Inc.	Other Healthcare		Term Loan	9.64%	5/1/2015	4,515	4,476	4,476	
Patientkeeper, Inc.	Other Healthcare		Term Loan	10.50%	12/1/2014	5,014	4,873	4,873	
Singulex, Inc.	Other Healthcare		Term Loan (1)	11.00%	3/1/2014	1,898	1,882	1,882	
			Term Loan (1)	11.00%	3/1/2014	1,265	1,257	1,257	
Talyst, Inc.	Other Healthcare		Term Loan (1)	12.10%	12/1/2013	1,152	1,142	1,142	
			Term Loan (1)	12.05%	12/1/2013	1,152	1,141	1,141	
Total Debt Investments — Healthcare information and services								33,053	33,053
Total Debt Investments								213,101	212,405
Warrant Investments									
Warrants — Life Science — 1.2%									
ACT Biotech Corporation	Biotechnology	1,390,910	Preferred Stock Warrants (1)	—	—	—	83	35	
Ambit Biosciences, Inc.	Biotechnology	1,075,083	Preferred Stock Warrants (1)	—	—	—	143	129	
Anacor Pharmaceuticals, Inc. (6)	Biotechnology	84,583	Common Stock Warrants (2)	—	—	—	93	79	
Anesiva, Inc. (6)	Biotechnology	198,898	Common Stock Warrants (1)	—	—	—	18	—	
Celsion Corporation (6)	Biotechnology	25,685	Common Stock Warrants (2)	—	—	—	15	66	
GenturaDx, Inc.	Biotechnology	1,161,290	Preferred Stock Warrants (2)	—	—	—	63	—	
N30 Pharmaceuticals, LLC	Biotechnology	214,200	Preferred Stock Warrants (1)(2)	—	—	—	122	256	
	Biotechnology	84,845		—	—	—	69	—	



Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Novalar Pharmaceuticals, Inc.			Preferred Stock Warrants (1)						
Revanche Therapeutics, Inc.	Biotechnology	199,470	Preferred Stock Warrants (1)	—	—	—	224	411	
Sample6 Technologies, Inc.	Biotechnology	200,582	Preferred Stock Warrants (2)	—	—	—	27	31	
Sunesis Pharmaceuticals, Inc. (6)	Biotechnology	116,203	Common Stock Warrants (2)	—	—	—	83	409	
Supernus Pharmaceuticals, Inc. (6)	Biotechnology	42,083	Preferred Stock Warrants (2)	—	—	—	94	297	
Tranzyme, Inc. (6)	Biotechnology	77,902	Common Stock Warrants (1)(2)	—	—	—	6	80	
EnteroMedics, Inc. (6)	Medical Device	141,026	Common Stock Warrants (1)	—	—	—	347	26	
Mitralign, Inc.	Medical Device	295,238	Common Stock Warrants	—	—	—	49	49	
OraMetrix, Inc.	Medical Device	812,348	Preferred Stock Warrants (1)(2)	—	—	—	78	1	
PixelOptics, Inc.	Medical Device	381,612	Preferred Stock Warrants (2)	—	—	—	96	42	
Tengion, Inc. (6)	Medical Device	8,161	Common Stock Warrants (2)	—	—	—	62	—	
ViOptix, Inc.	Medical Device	375,763	Preferred Stock Warrants (1)	—	—	—	13	—	
Total Warrants — Life Science							1,685	1,911	

See Notes to Consolidated Financial Statements

## Horizon Technology Finance Corporation and Subsidiaries

### Consolidated Schedule of Investments

September 30, 2012 — (Continued)

(In thousands)

Portfolio Company	Sector	Type of Investment (4)(8)	Interest Rate (5)	Maturity	Principal Amount (7)	Cost of Investments (7)	Fair Value
Warrants — Technology — 1.6%							
OpenPeak, Inc.	Communications	18,997 Preferred Stock Warrants (1)	—	—	—	89	—
Everyday Health, Inc.	Consumer-related Technologies	65,674 Preferred Stock Warrants (1)	—	—	—	69	103
SnagAJob.com, Inc.	Consumer-related Technologies	365,396 Preferred Stock Warrants (1)	—	—	—	23	268
Tagged, Inc.	Consumer-related Technologies	190,868 Preferred Stock Warrants (1)	—	—	—	27	81
Avalanche Technology, Inc.	Semiconductors	201,835 Preferred Stock Warrants (2)	—	—	—	45	45
Impinj, Inc.	Semi-conductor	109,362 Preferred Stock Warrants (1)	—	—	—	7	—
Luxtera, Inc.	Semiconductors	1,827,458 Preferred Stock Warrants (3)	—	—	—	34	34
Xtera Communications, Inc.	Semiconductors	983,607 Preferred Stock Warrants	—	—	—	206	201
XIOtech, Inc.	Data Storage	2,217,979 Preferred Stock Warrants (1)	—	—	—	22	12
Cartera Commerce, Inc.	Internet and media	90,909 Preferred Stock Warrants (1)	—	—	—	16	161
Grab Networks, Inc.	Internet and media	1,493,681 Preferred Stock	—	—	—	194	120

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

			Warrants (1)(3) Preferred						
Optaros, Inc.	Internet and media	477,403	Stock	—	—	—	21	20	
			Warrants (2) Preferred						
SimpleTuition, Inc.	Internet and media	189,573	Stock	—	—	—	63	63	
			Warrants Preferred						
IntelePeer, Inc.	Networking	141,549	Stock	—	—	—	39	489	
			Warrants (1) Preferred						
Motion Computing, Inc.	Networking	260,707	Stock	—	—	—	7	306	
			Warrants (1) Preferred						
Clarabridge, Inc.	Software	104,503	Stock	—	—	—	28	20	
			Warrants (1) Preferred						
Construction Software Technologies, Inc.	Software	196,226	Stock	—	—	—	45	35	
			Warrants (2) Preferred						
Courion Corporation	Software	772,543	Stock	—	—	—	107	111	
			Warrants (1)(3) Preferred						
DriveCam, Inc.	Software	71,639	Stock	—	—	—	20	120	
			Warrants (1) Preferred						
Netuitive, Inc.	Software	748,453	Stock	—	—	—	27	13	
			Warrants (1)(3) Preferred						
Recondo Technology, Inc.	Software	280,000	Stock	—	—	—	48	133	
			Warrants (2) Preferred						
Seapass Solutions, Inc.	Software	67,631	Stock	—	—	—	43	39	
			Warrants (2) Preferred						
StreamBase Systems, Inc.	Software	306,041	Stock	—	—	—	83	71	
			Warrants (1) Preferred						
Aquion Energy, Inc.	Power Management	82,644	Stock	—	—	—	7	7	
			Warrants (2) Preferred						
Xtreme Power, Inc.	Power Management	182,723	Stock	—	—	—	76	76	
			Warrants						
Total Warrants — Technology							1,346	2,528	
Warrants — Cleantech — 0.2%									
			Preferred						
Renmatix, Inc.	Alternative Energy	52,296	Stock	—	—	—	68	79	
			Warrants (2)						

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Semprius, Inc.	Alternative Energy	519,981	Preferred Stock Warrants (2)	—	—	—	25	30
Cereplast, Inc. (6)	Waste Recycling	365,000	Common Stock Warrants (1)	—	—	—	175	60
Enphase Energy, Inc. (6)	Energy Efficiency	161,959	Common Stock Warrants (1)	—	—	—	175	16
Satcon Technology Corporation (6)	Energy Efficiency	493,097	Common Stock Warrants (1)	—	—	—	285	—
Solarbridge Technologies, Inc.	Energy Efficiency	1,761,051	Preferred Stock Warrants	—	—	—	125	125
Tigo Energy, Inc.	Energy Efficiency	190,901	Preferred Stock Warrants (1)(2)	—	—	—	100	80
Total Warrants — Cleantech							953	390
Warrants — Healthcare information and services — 0.6%								
BioScale, Inc.	Diagnostics	315,618	Preferred Stock Warrants (1)	—	—	—	54	51
Precision Therapeutics, Inc.	Diagnostics	561,409	Preferred Stock Warrants	—	—	—	73	147
Radisphere National Radiology Group, Inc.	Diagnostics	519,943	Preferred Stock Warrants (1)(2)	—	—	—	378	328
Aperio Technologies, Inc.	Other Healthcare	197,473	Preferred Stock Warrants	—	—	—	34	274
Patientkeeper, Inc.	Other Healthcare	396,410	Preferred Stock Warrants	—	—	—	269	44
Singulex, Inc.	Other Healthcare	293,633	Preferred Stock Warrants (1)	—	—	—	44	73
Talyst, Inc.	Other Healthcare	300,360	Preferred Stock Warrants (1)	—	—	—	100	81
Total Warrants — Healthcare information and services							952	998
Total Warrants							4,936	5,827
Other Investments — 1.3%								
Vette Technology, LLC	Data Storage		Royalty Agreement (1)	—	4/18/2019	—	4,939	2,000
Total Other Investments							4,939	2,000
Equity — 0.4%								

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Insmed Incorporated (6)	Biotechnology	33,208	Common Stock (1)	—	—	—	227	151
Overture Networks Inc.	Communications	386,191	Preferred Stock (1)	—	—	—	482	526
Total Equity							709	677
Total Portfolio Investment Assets — 140.8%							\$ 223,685	\$ 220,909

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments****September 30, 2012 — (Continued)****(In thousands)**

Portfolio Company	Type of Sector Investment	Interest Rate (4)(8)	Maturity	Principal Amount	Cost of Investments (7)	Fair Value
Short Term Investments — Money Market Funds — 1.5%						
Blackrock Liquid Fed Funds Institutional (Fund #30)					\$ 836	\$836
First American Prime Obligations Fund (Class D)					1,294	1,294
Fidelity Prime Money Market (Class I Fund #690)					91	91
US Bank Money Market					145	145
Total Short Term Investments — Money Market Funds					\$ 2,366	\$2,366

(1) Has been pledged as collateral under the WestLB Facility.

(2) Has been pledged as collateral under the Wells Facility.

(3) Has been pledged as collateral under the Fortress Facility.

(4) All investments are less than 5% ownership of the class and ownership of the portfolio company.

All interest is payable in cash due monthly in arrears, unless otherwise indicated, and applies only to the Company's debt investments. Interest Rate is the annual interest rate on the debt investment and does not include end of the (5) term payments and any additional fees related to the investments, such as deferred interest, commitment fees or prepayment fees. All debt investments are at fixed rates for the term of the loan, unless otherwise indicated. For each debt investment, we have provided the current interest rate in effect as of September 30, 2012.

(6) Portfolio company is a public company.

(7) For debt investments, represents principal balance less unearned income.

(8) Preferred and common stock warrants, equity interests and other investments are non-income producing.

See Notes to Consolidated Financial Statements



**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments****December 31, 2011****(In thousands)**

Portfolio Company	Sector	Type of Investment (3)(7)	Interest Rate (4)	Maturity	Principal Amount	Cost of Investments (6)	Fair Value
Debt Investments							
Debt Investments — Life Science — 45.5%							
ACT Biotech Corporation	Biotechnology	Term Loan (1)	13.10%	12/1/2013	\$913	\$ 894	\$734
		Term Loan (1)	13.01%	12/1/2013	913	906	906
		Term Loan (1)	13.01%	12/1/2013	1,410	1,378	1,378
Ambit Biosciences Corporation	Biotechnology	Term Loan (1)	12.25%	10/1/2013	4,574	4,530	4,530
Anacor Pharmaceuticals, Inc. (5)	Biotechnology	Term Loan (2)	9.41%	4/1/2015	3,333	3,240	3,240
		Term Loan (2)	9.67%	4/1/2015	2,667	2,608	2,608
GenturaDx, Inc.	Biotechnology	Term Loan (2)	11.25%	4/1/2014	1,824	1,800	1,800
N30 Pharmaceuticals, LLC	Biotechnology	Term Loan (1)	11.25%	9/1/2014	2,500	2,447	2,447
		Term Loan (2)	11.25%	7/1/2015	2,500	2,413	2,413
Pharmasset, Inc. (5)	Biotechnology	Term Loan (1)	12.50%	10/1/2012	1,111	1,107	1,107
Revance Therapeutics, Inc.	Biotechnology	Convertible Note (1)	8.00%	2/10/2013	62	66	66
Sunesis Pharmaceuticals, Inc. (5)	Biotechnology	Term Loan (2)	8.95%	10/1/2015	2,000	1,943	1,943
Supernus Pharmaceuticals, Inc.	Biotechnology	Term Loan (2)	11.00%	8/1/2014	3,000	2,972	2,972
		Term Loan (2)	11.00%	7/1/2015	7,000	6,902	6,902
Tranzyme, Inc. (5)	Biotechnology	Term Loan (1)	10.75%	1/1/2014	4,104	4,088	4,088

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Xcovery Holding Company, LLC	Biotechnology	Term Loan (2)	12.00%	10/1/2013	1,444	1,440	1,240
		Term Loan (2)	12.00%	7/1/2014	1,500	1,480	1,480
OraMetrix, Inc.	Medical Device	Term Loan (1)	11.50%	4/1/2014	4,340	4,282	4,282
PixelOptics, Inc.	Medical Device	Term Loan (2)	10.75%	11/1/2014	10,000	9,921	9,921
Tengion, Inc. (5)	Medical Device	Term Loan (2)	11.75%	1/1/2014	5,000	4,958	4,661
ViOptix, Inc.	Medical Device	Term Loan (1)	13.55%	11/1/2011	418	417	417
Total Debt Investments — Life Science						59,792	59,135
Debt Investments — Technology — 35.7%							
OpenPeak, Inc.	Communications	Term Loan (1)	11.86%	12/1/2013	5,486	5,431	5,134
Starcite, Inc.	Consumer-related Technologies	Term Loan (1)	12.05%	9/1/2012	1,225	1,225	1,225
Tagged, Inc.	Consumer-related Technologies	Term Loan (1)	12.78%	5/1/2012	343	343	343
		Term Loan (1)	11.46%	8/1/2012	195	194	194
Xtera Communications, Inc.	Semiconductors	Term Loan	11.50%	12/1/2014	10,000	9,814	9,814
		Term Loan	11.50%	7/1/2015	2,000	1,951	1,951
Vette Corp.	Data Storage	Term Loan (1)	11.75%	7/1/2014	5,000	4,937	3,437
IntelPeer, Inc.	Networking	Term Loan (1)	12.43%	4/1/2012	139	139	139
		Term Loan (1)	12.33%	6/1/2012	214	214	214
		Term Loan (1)	12.33%	10/1/2012	573	570	570
Construction Software Technologies, Inc.	Software	Term Loan (2)	11.75%	12/1/2014	4,000	3,947	3,947
		Term Loan	11.75%	6/1/2014	2,000	1,972	1,972
Courion Corporation	Software	Term Loan (1)	11.45%	9/1/2014	7,000	6,904	6,904
Recondo Technology, Inc.	Software	Term Loan (2)	11.50%	4/1/2015	2,000	1,927	1,927
Seapass Solutions, Inc.	Software	Term Loan (2)	11.75%	11/1/2014	5,000	4,933	4,933
StreamBase Systems, Inc.	Software	Term Loan (1)	12.51%	11/1/2013	2,816	2,787	2,787
		Term Loan (1)	12.50%	6/1/2014	896	884	884
Total Debt Investments — Technology						48,172	46,375

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Debt Investments — Cleantech — 21.7%

Cereplast, Inc. (5)	Waste Recycling	Term Loan (1)	12.00%	4/1/2014	2,356	2,313	2,004
		Term Loan (1)	12.00%	6/1/2014	2,500	2,451	2,451
Aurora Algae, Inc.	Energy Efficiency	Term Loan (2)	10.50%	5/1/2015	2,500	2,476	2,476
Enphase Energy, Inc.	Energy Efficiency	Term Loan (1)	12.60%	10/1/2013	5,342	5,286	5,286
		Term Loan	10.75%	4/1/2015	2,000	1,972	1,972
		Term Loan	10.75%	4/1/2015	3,000	2,945	2,945
Satcon Technology Corporation (5)	Energy Efficiency	Term Loan (1)	12.58%	1/1/2014	7,882	7,740	7,740
Tigo Energy, Inc.	Energy Efficiency	Term Loan (1)	11.00%	8/1/2014	3,500	3,371	3,371
Total Debt Investments — Cleantech						28,554	28,245

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments****December 31, 2011 — (Continued)****(In thousands)**

Portfolio Company	Sector	Type of Investment (3)(7)	Interest Rate (4)	Maturity	Principal Amount	Cost of Investments (6)	Fair Value
Debt Investments — Healthcare information and services — 30.4%							
BioScale, Inc.	Diagnosics	Term Loan (1)	12.00%	8/1/2012	962	960	960
		Term Loan (1)	11.51%	1/1/2014	5,000	4,953	4,953
Precision Therapeutics, Inc.	Diagnosics	Term Loan	10.25%	12/1/2014	7,000	6,958	6,958
Radisphere National Radiology Group, Inc.	Diagnosics	Term Loan (1)	12.75%	1/1/2014	8,546	8,476	8,476
Aperio Technologies, Inc.	Other Healthcare	Term Loan	9.64%	5/1/2015	5,000	4,937	4,937
Patientkeeper, Inc.	Other Healthcare	Term Loan	10.50%	12/1/2014	5,500	5,257	5,257
Singulex, Inc.	Other Healthcare	Term Loan (1)	11.00%	3/1/2014	2,736	2,709	2,709
		Term Loan (1)	11.00%	3/1/2014	1,824	1,806	1,806
Talyst, Inc.	Other Healthcare	Term Loan (1)	12.10%	12/1/2013	1,765	1,739	1,739
		Term Loan (1)	12.05%	12/1/2013	1,764	1,736	1,736
Total Debt Investment — Healthcare information and services						39,531	39,531
<b>Total Debt Investments</b>						176,049	173,286
Warrant Investments							
Warrants — Life Science — 0.9%							
ACT Biotech Corporation	Biotechnology	1,232,562 Preferred Stock Warrants (1)	—	—	—	71	27
Ambit Biosciences, Inc.	Biotechnology	1,075,083 Preferred Stock Warrants	—	—	—	143	131

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Anacor Pharmaceuticals, Inc. (5)	Biotechnology	56,508	(1) Common Stock Warrants	—	—	—	67	42
Anesiva, Inc. (5)	Biotechnology	198,898	(2) Common Stock Warrants	—	—	—	18	—
GenturaDx, Inc.	Biotechnology	1,161,290	(1) Preferred Stock Warrants	—	—	—	63	49
N30 Pharmaceuticals, LLC	Biotechnology	2,142	(2) Preferred Stock Warrants	—	—	—	122	249
Novalar Pharmaceuticals, Inc.	Biotechnology	84,845	(1)(2) Preferred Stock Warrants	—	—	—	69	—
Revanche Therapeutics, Inc.	Biotechnology	199,470	(1) Preferred Stock Warrants	—	—	—	224	496
Sunesis Pharmaceuticals, Inc. (5)	Biotechnology	77,220	(1) Common Stock Warrants	—	—	—	9	9
Supernus Pharmaceuticals, Inc.	Biotechnology	168,333	(2) Preferred Stock Warrants	—	—	—	93	168
Tranzyme, Inc. (5)	Biotechnology	14,959	(2) Common Stock Warrants	—	—	—	1	—
EnteroMedics, Inc. (5)	Medical Device	141,026	(1) Common Stock Warrants	—	—	—	347	—
OraMetrix, Inc.	Medical Device	649,878	(1) Preferred Stock Warrants	—	—	—	78	1
PixelOptics, Inc.	Medical Device	381,612	(1) Preferred Stock Warrants	—	—	—	96	34
Tengion, Inc. (5)	Medical Device	81,608	(2) Common Stock	—	—	—	62	—

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

			Warrants (2)						
ViOptix, Inc.	Medical Device	375,763	Preferred Stock Warrants (1)	—	—	—	13	—	
Total Warrants — Life Science Warrants — Technology — 1.5%							1,476	1,206	
OpenPeak, Inc.	Communications	18,997	Preferred Stock Warrants (1)	—	—	—	89	—	
Everyday Health, Inc.	Consumer-related Technologies	65,674	Preferred Stock Warrants (1)	—	—	—	69	103	
SnagAJob.com, Inc.	Consumer-related Technologies	365,396	Preferred Stock Warrants (1)	—	—	—	23	269	
Tagged, Inc.	Consumer-related Technologies	168,909	Preferred Stock Warrants (1)	—	—	—	17	81	
Xtera Communications, Inc.	Semiconductors	983,607	Preferred Stock Warrants	—	—	—	206	202	
Vette Corp.	Data Storage	509,099	Preferred Stock Warrants (1)	—	—	—	75	—	
XIOtech, Inc.	Data Storage	2,217,979	Preferred Stock Warrants (1)	—	—	—	22	72	
Cartera Commerce, Inc.	Internet and media	90,909	Preferred Stock Warrants (1)	—	—	—	16	24	
Grab Networks, Inc.	Networking	793,681	Preferred Stock Warrants (1)	—	—	—	74	—	
IntelePeer, Inc.	Networking	141,549	Preferred Stock Warrants (1)	—	—	—	39	521	
Motion Computing, Inc.	Networking	260,707	Preferred Stock Warrants (1)	—	—	—	7	305	

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Impinj, Inc.	Semi-conductor	109,362	Preferred Stock Warrants (1)	—	—	—	7	—
Clarabridge, Inc.	Software	104,503	Preferred Stock Warrants (1)	—	—	—	28	20
Construction Software Technologies, Inc.	Software	196,226	Preferred Stock Warrants (2)	—	—	—	45	35
Courion Corporation	Software	559,428	Preferred Stock Warrants (1)	—	—	—	85	81
DriveCam, Inc.	Software	71,639	Preferred Stock Warrants (1)	—	—	—	20	120
Netuitive, Inc.	Software	168,796	Preferred Stock Warrants (1)	—	—	—	27	18
Recondo Technology, Inc.	Software	280,000	Preferred Stock Warrants (2)	—	—	—	47	38
Seapass Solutions, Inc.	Software	67,631	Preferred Stock Warrants (2)	—	—	—	43	34
StreamBase Systems, Inc.	Software	235,416	Preferred Stock Warrants (1)	—	—	—	67	68
Total Warrants — Technology							1,006	1,991

See Notes to Consolidated Financial Statements

## Horizon Technology Finance Corporation and Subsidiaries

**Consolidated Schedule of Investments**  
**December 31, 2011 — (Continued)**  
**(In thousands)**

Portfolio Company	Sector	Type of Investment (3)	(7)	Interest Rate (4)	Maturity	Principal Amount (5)	Cost of Investments (6)	Fair Value
Warrants — Cleantech — 0.1%								
Cereplast, Inc. (5)	Waste Recycling	140,000	Common Stock Warrants (1)	—	—	—	112	—
Enphase Energy, Inc.	Energy Efficiency	1,470,589	Preferred Stock Warrants (1)	—	—	—	175	110
Satcon Technology Corporation (5)	Energy Efficiency	493,097	Common Stock Warrants (1)	—	—	—	285	—
Tigo Energy, Inc.	Energy Efficiency	190,901	Preferred Stock Warrants (1)	—	—	—	101	80
Total Warrants — Cleantech							673	190
Warrants — Healthcare information and services — 0.5%								
BioScale, Inc.	Diagnostics	315,618	Preferred Stock Warrants (1)	—	—	—	54	51
Precision Therapeutics, Inc.	Diagnostics	561,409	Preferred Stock Warrants	—	—	—	73	158
Radisphere National Radiology Group, Inc.	Diagnostics	248,788	Preferred Stock Warrants (1)	—	—	—	167	325
Aperio Technologies, Inc.	Other Healthcare	197,473	Preferred Stock Warrants	—	—	—	34	27
Patientkeeper, Inc.	Other Healthcare	396,410	Preferred Stock Warrants	—	—	—	269	44
Singulex, Inc.	Other Healthcare	259,576	Preferred Stock Warrants (1)	—	—	—	39	25
Talyst, Inc.	Other Healthcare	300,360	Preferred Stock Warrants (1)	—	—	—	100	81



Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

			Preferred Stock Warrants (1)				
Total Warrants — Healthcare information and services						736	711
Total Warrants						3,891	4,098
Equity — 0.5%							
Insmed Incorporated (5)	Biotechnology	33,208	Common Stock (1)	—	—	227	101
Overture Networks Inc.	Communications	386,191	Preferred Stock (1)	—	—	482	526
Active Networks (5)	Consumer-related Technologies	128	Common Stock (1)	—	—	2	2
Total Equity						711	629
<b>Total Portfolio Investment Assets — 137.1%</b>						\$ 180,651	\$ 178,013
Short Term Investments — Money Market Funds — 10.4%							
Blackrock Liquid Fed Funds Institutional (Fund #30)						\$ 9,861	\$ 9,861
First American Prime Obligations Fund (Class D)						2,966	2,966
Fidelity Prime Money Market (Class I Fund #690)						691	691
<b>Total Short Term Investments — Money Market Funds</b>						\$ 13,518	\$ 13,518

(1) Has been pledged as collateral under the WestLB Facility.

(2) Has been pledged as collateral under the Wells Facility.

(3) All investments are less than 5% ownership of the class and ownership of the portfolio company.

All interest is payable in cash due monthly in arrears, unless otherwise indicated, and applies only to the Company's debt investments. Interest Rate is the annual interest rate on the debt investment and does not include end of term payments and any additional fees related to the investment, such as deferred interest, commitment fees or prepayment fees. All debt investments are at fixed rates for the term of the loan, unless otherwise indicated. For each debt investment, we have provided the current interest rate in effect as of December 31, 2011.

(5) Portfolio company is a public company.

(6) For debt investments, represents principal balance less unearned income.

(7) Preferred and common stock warrants and equity interests are non-income producing.

See Notes to Consolidated Financial Statements

## **Horizon Technology Finance Corporation and Subsidiaries**

### **Notes to Consolidated Financial Statements**

**(In thousands, except shares and per share data)**

#### **Note 1. Organization**

Horizon Technology Finance Corporation (the “Company”) was organized as a Delaware corporation on March 16, 2010 and is an externally managed, non-diversified, closed end investment company. The Company has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (“1940 Act”). In addition, for tax purposes, the Company has elected to be treated as a regulated investment company (“RIC”) as defined in Subtitle A, Chapter 1, under Subchapter M of the Internal Revenue Code of 1986, as amended (the “Code”). As a RIC, the Company is not subject to federal income tax on the portion of its taxable income and capital gains the Company distributes to the stockholders. The Company primarily makes secured loans to development-stage companies in the technology, life science, healthcare information and services and cleantech industries.

On October 28, 2010 the Company completed an initial public offering (“IPO”) and its common stock trades on the NASDAQ Global Select Market under the symbol “HRZN”. The Company was formed to continue and expand the business of Compass Horizon Funding Company LLC (“CHF”), a Delaware limited liability company, which commenced operations in March 2008 and became the Company’s wholly owned subsidiary with the completion of the IPO.

Horizon Credit I LLC (“Credit I”) was formed as a Delaware limited liability company on January 23, 2008, with CHF as the sole equity member. Credit I is a special purpose bankruptcy remote entity and is reported herein as a wholly owned subsidiary of the Company. Credit I is a separate legal entity from the Company and CHF and the assets conveyed to Credit I are not available to creditors of the Company or any other entity other than Credit I’s lenders.

Horizon Credit II LLC (“Credit II”) was formed as a Delaware limited liability company on June 28, 2011, with the Company as the sole equity member. Credit II is a special purpose bankruptcy remote entity and is a separate legal entity from the Company. Any assets conveyed to Credit II are not available to creditors of the Company or any other entity other than Credit II’s lenders.

Horizon Credit III LLC (“Credit III”) was formed as a Delaware limited liability company on May 30, 2012, with the Company as the sole equity member. Credit III is a special purpose bankruptcy remote entity and is a separate legal entity from the Company. Any assets conveyed to Credit III are not available to creditors of the Company or any other entity other than Credit III’s lenders.

Longview SBIC GP LLC and Longview SBIC LP (collectively, “Horizon SBIC”) were formed as a Delaware limited liability company and Delaware limited partnership, respectively, on February 11, 2011. Horizon SBIC are wholly owned subsidiaries of the Company and were formed in anticipation of obtaining a license to operate a small business investment company from the U. S. Small Business Administration. There has been no activity in Horizon SBIC since their inception.

The Company’s investment strategy is to maximize the investment portfolio’s return by generating current income from the loans made and the capital appreciation from the warrants received when making such loans. The Company has entered into an investment management agreement (the “Investment Management Agreement”) with Horizon Technology Finance Management LLC (“HTFM” or the “Advisor”), under which the Advisor will manage the day-to-day operations of, and provide investment advisory services to, the Company.

## **Note 2. Basis of Presentation and Significant Accounting Policies**

### ***Basis of Financial Statement Presentation***

The consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and pursuant to the requirements for reporting on Form 10-Q and Articles 6 or 10 of Regulation S-X. In the opinion of management, the consolidated financial statements reflect all adjustments and reclassifications that are necessary for the fair presentation of financial results as of and for the periods presented. All intercompany balances and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation.

### ***Principles of Consolidation***

As permitted under Regulation S-X and the AICPA Audit and Accounting Guide for Investment Companies, the Company will generally not consolidate its investment in a company other than an investment company subsidiary or a controlled operating company whose business consists of providing services to the Company. Accordingly, the Company consolidated the results of the Company’s subsidiaries in its consolidated financial statements.



## **Horizon Technology Finance Corporation and Subsidiaries**

### **Notes to Consolidated Financial Statements**

**(In thousands, except shares and per share data)**

#### *Use of Estimates*

In preparing the consolidated financial statements in accordance with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, as of the date of the balance sheet and income and expenses for the period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the valuation of investments.

#### *Fair Value*

The Company applies fair value to substantially all of its investments in accordance with relevant GAAP, which establishes a framework used to measure fair value and requires disclosures for fair value measurements. The Company has categorized its investments carried at fair value, based on the priority of the valuation technique, into a three-level fair value hierarchy as more fully described in Note 5. Fair value is a market-based measure considered from the perspective of the market participant who holds the financial instrument rather than an entity specific measure. Therefore, when market assumptions are not readily available, the Company's own assumptions are set to reflect those that management believes market participants would use in pricing the financial instrument at the measurement date.

The availability of observable inputs can vary depending on the financial instrument and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new, whether the product is traded on an active exchange or in the secondary market and the current market conditions. To the extent that the valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for financial instruments classified as Level 3.

In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards

(IFRSs), (ASU 2011-04). ASU 2011-04 converges the fair value measurement guidance in U.S. GAAP and IFRSs. Some of the amendments clarify the application of existing fair value measurement requirements, while other amendments change a particular principle in existing guidance. In addition, ASU 2011-04 requires additional fair value disclosures. The Company has adopted ASU 2011-04 and included the additional required disclosures in Note 5.

See Note 5 for additional information regarding fair value.

### ***Segments***

The Company has determined that it has a single reporting segment and operating unit structure. The Company lends to and invests in portfolio companies in various technology, life science, healthcare information and services and cleantech industries. The Company separately evaluates the performance of each of its lending and investment relationships. However, because each of these loan and investment relationships has similar business and economic characteristics, they have been aggregated into a single lending and investment segment.

### ***Investments***

Investments are recorded at fair value. The Company's board of directors ("Board") determines the fair value of its portfolio investments. The Company has the intent to hold its loans for the foreseeable future or until maturity or payoff.

Interest on debt investments is accrued and included in income based on contractual rates applied to principal amounts outstanding. Interest income is determined using a method that results in a level rate of return on principal amounts outstanding. When a loan becomes 90 days or more past due, or if the Company otherwise does not expect to receive interest and principal repayments, the loan is placed on non-accrual status and the recognition of interest income is discontinued. Interest payments received on loans that are on non-accrual status are treated as reductions of principal until the principal is repaid. There were no loans on non-accrual status as of September 30, 2012 and December 31, 2011.

The Company receives a variety of fees from borrowers in the ordinary course of conducting its business, including advisory fees, commitment fees, amendment fees, non-utilization fees and prepayment fees. In a limited number of cases, the Company may also receive a non-refundable deposit earned upon the termination of a transaction. Loan origination fees, net of certain direct origination costs, are deferred and, along with unearned income, are amortized as a level yield adjustment over the respective term of the loan. Fees for counterparty loan commitments with multiple loans are allocated to each loan based upon each loan's relative fair value. When a loan is placed on non-accrual status, the amortization of the related fees and unearned income is discontinued until the loan is returned to accrual status.



## **Horizon Technology Finance Corporation and Subsidiaries**

### **Notes to Consolidated Financial Statements**

**(In thousands, except shares and per share data)**

Certain loan agreements also require the borrower to make an end-of-term payment that is accrued into income over the life of the loan to the extent such amounts are expected to be collected. The Company will generally cease accruing the income if there is insufficient value to support the accrual or the Company does not expect the borrower to be able to pay all principal and interest due.

In connection with substantially all lending arrangements, the Company receives warrants to purchase shares of stock from the borrower. The warrants are recorded as assets at estimated fair value on the grant date using the Black-Scholes valuation model. The warrants are considered loan fees and are also recorded as unearned loan income on the grant date. The unearned income is recognized as interest income over the contractual life of the related loan in accordance with the Company's income recognition policy. Subsequent to loan origination, the warrants are also measured at fair value using the Black-Scholes valuation model. Any adjustment to fair value is recorded through earnings as net unrealized gain or loss on investments. Gains from the disposition of the warrants or stock acquired from the exercise of warrants are recognized as realized gains on investments.

### ***Debt Issuance Costs***

Debt issuance costs are fees and other direct incremental costs incurred by the Company in obtaining debt financing from its lenders and issuing debt securities. Debt issuance costs are recognized as assets and amortized as interest expense over the term of the related borrowings. The unamortized balance of debt issuance costs as of September 30, 2012 and December 31, 2011, included in other assets, was \$3.8 million and \$1.1 million, respectively. The accumulated amortization balances as of September 30, 2012 and December 31, 2011 were \$0.4 and \$0.1 million, respectively. The amortization expense for the nine months ended September 30, 2012 and 2011 relating to debt issuance costs was \$0.3 million and \$0.2 million, respectively.

### ***Income Taxes***

The Company elected to be treated as a RIC under subchapter M of the Code and operates in a manner so as to qualify for the tax treatment applicable to RICs. In order to qualify as a RIC, among other things, the Company is required to



meet certain source of income and asset diversification requirements and timely distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code, for each year. The Company, among other things, has made and intends to continue to make the requisite distributions to its stockholders, which will generally relieve the Company from U.S. federal income taxes.

Depending on the level of taxable income earned in a tax year, the Company may choose to carry forward taxable income in excess of current year dividend distributions into the next tax year and pay a 4% excise tax on such income, as required. To the extent that the Company determines that its estimated current year annual taxable income will be in excess of estimated current year dividend distributions, the Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned. For the three and nine months ended September 30, 2012 and 2011, no amount was recorded for U.S. federal excise tax.

The Company evaluates tax positions taken in the course of preparing the Company's tax returns to determine whether the tax positions are "more-likely-than-not" to be sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold, or uncertain tax positions, would be recorded as a tax expense in the current year. It is the Company's policy to recognize accrued interest and penalties related to uncertain tax benefits in income tax expense. There were no material uncertain tax positions at September 30, 2012 and December 31, 2011. The 2011, 2010 and 2009 tax years remain subject to examination by U.S. federal and state tax authorities.

### *Dividends*

Dividends and distributions to common stockholders are recorded on the declaration date. The amount to be paid out as a dividend is determined by the Board. Net realized capital gains, if any, are distributed at least annually, although the Company may decide to retain such capital gains for investment.

The Company has adopted a dividend reinvestment plan that provides for reinvestment of cash distributions and other distributions on behalf of its stockholders, unless a stockholder elects to receive cash. As a result, if the Board authorizes, and the Company declares, a cash dividend, then stockholders who have not "opted out" of the dividend reinvestment plan will have their cash dividends automatically reinvested in additional shares of the Company's common stock, rather than receiving the cash dividend. The Company may use newly issued shares to implement the plan (especially if the Company's shares are trading at a premium to net asset value), or the Company may purchase shares in the open market in connection with the obligations under the plan.

## **Horizon Technology Finance Corporation and Subsidiaries**

### **Notes to Consolidated Financial Statements**

**(In thousands, except shares and per share data)**

#### ***Interest Rate Swaps and Hedging Activities***

The Company entered into interest rate swap agreements to manage interest rate risk. The Company does not hold or issue interest rate swap agreements or other derivative financial instruments for speculative purposes.

The interest rate swaps are recorded at fair value with changes in fair value reflected in net unrealized appreciation or depreciation of investments during the reporting period. The Company records the accrual of periodic interest settlements of interest rate swap agreements in net unrealized appreciation or depreciation of investments and subsequently records the amount as a net realized gain or loss on investments on the interest settlement date. Cash payments received or paid for the termination of an interest rate swap agreement would be recorded as a realized gain or loss upon termination in the consolidated statements of operations.

#### ***Transfers of Financial Assets***

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company — put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the transferor does not maintain effective control over the transferred assets through either (a) an agreement that both entitles and obligates the transferor to repurchase or redeem the assets before maturity or (b) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call.

### **Note 3. Related Party Transactions**

#### ***Investment Management Agreement***

On October 28, 2010, the Company entered into the Investment Management Agreement with the Advisor, under which the Advisor manages the day-to-day operations of, and provides investment advisory services to, the Company. Under the terms of the Investment Management Agreement, the Advisor determines the composition of the Company's investment portfolio, the nature and timing of the changes to the investment portfolio and the manner of implementing such changes; identifies, evaluates and negotiates the structure of the investments the Company makes (including performing due diligence on the Company's prospective portfolio companies); and closes, monitors and administers the investments the Company makes, including the exercise of any voting or consent rights.

The Advisor's services under the Investment Management Agreement are not exclusive to the Company, and the Advisor is free to furnish similar services to other entities so long as its services to the Company are not impaired. The Advisor is a registered investment advisor with the SEC. The Advisor receives fees for providing services, consisting of two components, a base management fee and an incentive fee.

The base management fee under the Investment Management Agreement is calculated at an annual rate of 2.00% of the Company's gross assets, payable monthly in arrears. For purposes of calculating the base management fee, the term "gross assets" includes any assets acquired with the proceeds of leverage. The accrued management fee as of September 30, 2012 and December 31, 2011 was \$0.4 million and \$0.3 million, respectively. The base management fee expense for both the three months ended September 30, 2012 and 2011 was \$1.1 million. The base management fee expense for the nine months ended September 30, 2012 and 2011 was \$3.0 million and \$3.2 million, respectively.

The incentive fee has two parts, as follows:

The first part is calculated and payable quarterly in arrears based on the Company's pre-incentive fee net investment income for the immediately preceding calendar quarter. For this purpose, pre-incentive fee net investment income means interest income, dividend income and any other income (including any other fees (other than fees for providing managerial assistance), such as commitment, origination, structuring, diligence and consulting fees or other fees received from portfolio companies) accrued during the calendar quarter, minus operating expenses for the quarter (including the base management fee, expenses payable under the administration agreement (as defined below), and any interest expense and any dividends paid on any issued and outstanding preferred stock, but excluding the incentive fee). Pre-incentive fee net investment income includes, in the case of investments with a deferred interest feature (such as original issue discount, debt instruments with payment-in-kind interest and zero coupon securities), accrued income that we have not yet received in cash. The incentive fee with respect to the pre-incentive fee net investment income is 20.00% of the amount, if any, by which the pre-incentive fee net investment income for the immediately preceding calendar quarter exceeds a 1.75% (which is 7.00% annualized) hurdle rate and a "catch-up" provision measured as of the end of each calendar quarter. Under this provision, in any calendar quarter, the Advisor receives no incentive fee until the net investment income equals the hurdle rate of 1.75%, but then receives, as a "catch-up," 100.00% of the pre-incentive fee net investment income with respect to that portion of such pre-incentive fee net investment income, if any, that exceeds the hurdle rate but is less than 2.1875%. The effect of this provision is that, if pre-incentive fee net investment income exceeds 2.1875% in any calendar quarter, the Advisor will receive 20.00% of the pre-incentive fee net investment income as if a hurdle rate did not apply.



## **Horizon Technology Finance Corporation and Subsidiaries**

### **Notes to Consolidated Financial Statements**

**(In thousands, except shares and per share data)**

Pre-incentive fee net investment income does not include any realized capital gains, realized capital losses or unrealized capital appreciation or depreciation. Because of the structure of the incentive fee, it is possible that the Company may pay an incentive fee in a quarter in which the Company incurs a loss. For example, if the Company receives pre-incentive fee net investment income in excess of the quarterly minimum hurdle rate, the Company will pay the applicable incentive fee even if the Company has incurred a loss in that quarter due to realized and unrealized capital losses. The Company's net investment income used to calculate this part of the incentive fee is also included in the amount of the Company's gross assets used to calculate the 2.00% base management fee. These calculations are appropriately prorated for any period of less than three months and adjusted for any share issuances or repurchases during the current quarter.

The second part of the incentive fee is determined and payable in arrears as of the end of each calendar year (or upon termination of the Investment Management Agreement, as of the termination date), and equals 20.00% of the Company's aggregate realized capital gains, if any, on a cumulative basis from the date of the election to be a BDC through the end of each calendar year, computed net of all realized capital losses and unrealized capital depreciation through the end of such year, less all previous amounts paid in respect of the capital gain incentive fee.

The performance based incentive fee expense was approximately \$0.7 million and \$0.6 million for the three months ended September 30, 2012 and 2011, respectively. The performance based incentive fee expense was approximately \$2.0 million and \$2.7 million for the nine months ended September 30, 2012 and 2011, respectively. The incentive fee payable as of September 30, 2012 and December 31, 2011 was \$0.7 million and \$1.8 million, respectively. The incentive payable as of September 30, 2012 includes \$0.7 million for part one and no accrual for part two of the incentive fee. The incentive fee payable as of December 31, 2011 included \$1.4 million for part one and \$0.4 million for part two of the incentive fee.

### ***Administration Agreement***

The Company entered into an Administration Agreement with the Advisor to provide administrative services to the Company. For providing these services, facilities and personnel, the Company will reimburse the Advisor for the Company's allocable portion of overhead and other expenses incurred by the Advisor in performing its obligations under the Administration Agreement, including rent, the fees and expenses associated with performing compliance

functions and the Company's allocable portion of the costs of compensation and related expenses of the Company's chief compliance officer and chief financial officer and their respective staffs. For both the three months ended September 30, 2012 and 2011, \$0.4 million was charged to operations under the Administration Agreement. For both the nine months ended September 30, 2012 and 2011, \$0.9 million was charged to operations under the Administration Agreement.

**Note 4. Investments**

Investments, all of which are with portfolio companies in the United States, consisted of the following:

	September 30, 2012		December 31, 2011	
	Cost	Fair Value	Cost	Fair Value
Money market funds	\$2,366	\$ 2,366	\$13,518	\$ 13,518
Non-affiliate investments				
Debt	\$213,101	\$ 212,405	\$176,049	\$ 173,286
Warrants	4,936	5,827	3,891	4,098
Other Investments	4,939	2,000	—	—
Equity	709	677	711	629
Total non-affiliate investments	\$ 223,685	\$ 220,909	\$ 180,651	\$ 178,013

**Horizon Technology Finance Corporation and Subsidiaries****Notes to Consolidated Financial Statements****(In thousands, except shares and per share data)**

The following table shows the Company's portfolio investments by industry sector:

	September 30, 2012		December 31, 2011	
	Cost	Fair Value	Cost	Fair Value
Life Science				
Biotechnology	\$49,891	\$ 50,568	\$41,322	\$ 41,127
Medical Device	19,649	18,930	20,173	19,315
Technology				
Consumer-Related Technologies	118	452	1,871	2,217
Networking	106	855	1,043	1,749
Software	26,929	27,072	23,715	23,768
Data Storage	4,962	2,012	5,051	3,533
Internet and Media	10,023	10,093	—	—
Communications	572	526	6,003	5,660
Semiconductors	20,057	20,044	11,979	11,967
Power Management	15,856	15,856	—	—
Healthcare Information and Services				
Diagnostics	18,787	18,808	21,640	21,881
Other Healthcare Related Services	15,218	15,243	18,627	18,361
Cleantech				
Energy Efficiency	28,584	28,121	24,351	23,980
Waste Recycling	4,281	3,662	4,876	4,455
Alternative Energy	8,652	8,667	—	—
Total non-affiliate investments	\$223,685	\$ 220,909	\$180,651	\$ 178,013

**Note 5. Fair Value**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Fair value is 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. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for certain assets or liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the

discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

Fair value measurements focus on exit prices in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment.

The Company's fair value measurements are classified into a fair value hierarchy based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three categories within the hierarchy are as follows:

**Level 1** Quoted prices in active markets for identical assets and liabilities.

**Level 2** Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active and model-based valuation techniques for which all significant inputs are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.



## Horizon Technology Finance Corporation and Subsidiaries

### Notes to Consolidated Financial Statements

(In thousands, except shares and per share data)

Investments are valued at fair value as determined in good faith by the Board, based on input of management, the audit committee and independent valuation firms that have been engaged at the direction of the Board to assist in the valuation of each portfolio investment without a readily available market quotation at least once during a trailing twelve-month period under a valuation policy and a consistently applied valuation process. This valuation process is conducted at the end of each fiscal quarter, with approximately 25% (based on fair value) of the Company's valuation of portfolio companies without readily available market quotations subject to review by an independent valuation firm.

*Cash and interest receivable:* The carrying amount is a reasonable estimate of fair value. These financial instruments are not recorded at fair value on a recurring basis and are categorized as Level 1 within the fair value hierarchy described above.

*Money Market Funds:* The carrying amounts are valued at their net asset value as of the close of business on the day of valuation. These financial instruments are recorded at fair value on a recurring basis and are categorized as Level 2 within the fair value hierarchy described above as these funds can be redeemed daily.

*Debt Investments:* For variable rate debt investments which re-price frequently and have no significant fair value change in credit risk, carrying values are a reasonable estimate of fair values. The fair value of fixed rate debt investments is estimated by discounting the expected future cash flows using the year end rates at which similar debt investments would be made to borrowers with similar credit ratings and for the same remaining maturities. At both September 30, 2012 and December 31, 2011, the discount rates used ranged from 8% to 25%. Significant increases (decreases) in this unobservable input would result in a significantly lower (higher) fair value measurement. These assets are recorded at fair value on a recurring basis and are categorized as Level 3 within the fair value hierarchy described above.

Under certain circumstances the Company may use an alternative technique to value debt investments that better reflects its fair value, such as the use of multiple probability weighted cash flow models when the expected future cash flows contain elements of variability.

*Warrant Investments:* The Company values its warrants using the Black-Scholes valuation model incorporating the following material assumptions:

Underlying asset value of the issuer is estimated based on information available, including any information regarding the most recent rounds of borrower funding. Significant increases (decreases) in this unobservable input would result in a significantly higher (lower) fair value measurement.

Volatility, or the amount of uncertainty or risk about the size of the changes in the warrant price, is based on guideline publicly traded companies within indices similar in nature to the underlying company issuing the warrant. A total of seven such indices were used. The weighted average volatility assumptions used for the warrant valuation at September 30, 2012 and December 31, 2011 was 24%. Significant increases (decreases) in this unobservable input would result in a significantly higher (lower) fair value measurement.

The risk-free interest rates are derived from the U.S. Treasury yield curve. The risk-free interest rates are calculated based on a weighted average of the risk-free interest rates that correspond closest to the expected remaining life of the warrant. The risk free rates used for the warrant valuations at September 30, 2012 and December 31, 2011 ranged from 0.17% to 0.62%, and from 0.12% to 0.83%, respectively.

Other adjustments, including a marketability discount on private company warrants, are estimated based on management's judgment about the general industry environment. The marketability discount used for the warrant valuations at both September 30, 2012 and December 31, 2011 was 20%. Significant increases (decreases) in this unobservable input would result in a significantly lower (higher) fair value measurement.

Under certain circumstances the Company may use an alternative technique to value warrants that better reflects the warrants fair value, such as an expected settlement of a warrant in the near term or a model that incorporates a put feature associated with the warrant. The fair value may be determined based on the expected proceeds to be received from such settlement or based on the net present value of the expected proceeds from the put option.

## Horizon Technology Finance Corporation and Subsidiaries

### Notes to Consolidated Financial Statements

(In thousands, except shares and per share data)

The fair value of the Company's warrants held in publicly traded companies is determined based on inputs that are readily available in public markets or can be derived from information available in public markets. Therefore, the Company has categorized these warrants as Level 2 within the fair value hierarchy described above. The fair value of the Company's warrants held in private companies is determined using both observable and unobservable inputs and represents management's best estimate of what market participants would use in pricing the warrants at the measurement date. Therefore, the Company has categorized these warrants as Level 3 within the fair value hierarchy described above. These assets are recorded at fair value on a recurring basis.

*Equity Investments:* The fair value of an equity investment in a privately held company is initially the face value of the amount invested. The Company adjusts the fair value of equity investments in private companies upon the completion of a new third-party round of equity financing. The Company may make adjustments to fair value, absent a new equity financing event, based upon positive or negative changes in a portfolio company's financial or operational performance. Significant increases (decreases) in this unobservable input would result in a significantly higher (lower) fair value measurement. The Company has categorized these equity investments as Level 3 within the fair value hierarchy described above. The fair value of an equity investment in a publicly traded company is based upon the closing public share price on the date of measurement. Therefore, the Company has categorized these equity investments as Level 1 within the fair value hierarchy described above. These assets are recorded at fair value on a recurring basis.

*Other Investments:* Other investments will be valued based on the facts and circumstances of the underlying agreement. The Company currently values one contractual agreement using a multiple probability weighted cash flow model as the contractual future cash flows contain elements of variability. Significant changes in the estimated cash flows and probability weightings would result in a significantly higher or lower fair value measurement. The Company has categorized this other investment as Level 3 within the fair value hierarchy described above. These assets are recorded at fair value on a recurring basis.

*Borrowings:* The carrying amount of borrowings under the revolving credit facilities and the term loan facility approximate fair value due to the variable interest rate of these credit facilities and are categorized as Level 2 within the fair value hierarchy described above. Additionally, the Company considers its creditworthiness in determining the fair value of such borrowings. The fair value of our fixed rate Senior Notes (See Note 6 below) is based on the closing public share price on the date of measurement and approximates the carrying value as of September 30, 2012. Therefore, the Company has categorized this borrowing as Level 1 within the fair value hierarchy described above.

These liabilities are not recorded at fair value on a recurring basis.

*Off-Balance-Sheet Instruments:* Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings. Therefore, the Company has categorized these instruments as Level 3 within the fair value hierarchy described above. Off-balance-sheet instruments are not recorded at fair value on a recurring basis.

The following tables detail the assets and liabilities that are carried at fair value and measured at fair value on a recurring basis as of September 30, 2012 and December 31, 2011, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	September 30, 2012			
	Total	Level 1	Level 2	Level 3
Money market funds	\$2,366	\$—	\$2,366	\$—
Debt investments	\$212,405	\$—	\$—	\$212,405
Warrant investments	\$5,827	\$—	\$1,035	\$4,792
Other investments	\$2,000	\$—	\$—	\$2,000
Equity investments	\$677	\$151	\$—	\$526

	December 31, 2011			
	Total	Level 1	Level 2	Level 3
Money market funds	\$13,518	\$—	\$13,518	\$—
Debt investments	\$173,286	\$—	\$—	\$173,286
Warrant investments	\$4,098	\$—	\$50	\$4,048
Equity investments	\$629	\$103	\$—	\$526

**Horizon Technology Finance Corporation and Subsidiaries****Notes to Consolidated Financial Statements****(In thousands, except shares and per share data)**

The following tables show a reconciliation of the beginning and ending balances for Level 3 assets for the three months ended September 30, 2012 and 2011:

	For the three months ended September 30, 2012				Total
	Debt Investments	Warrant Investments	Equity Investments	Other Investments	
Level 3 assets, beginning of period	\$ 187,932	\$ 4,355	\$ 526	\$ 2,000	\$ 194,813
Purchase of investments	36,464	—	—	—	36,464
Warrants received and classified as Level 3	—	397	—	—	397
Principal payments received on investments	(12,066 )	—	—	—	(12,066 )
Unrealized (depreciation) appreciation included in earnings	339	40	—	—	379
Other	(264 )	—	—	—	(264 )
Level 3 assets, end of period	\$ 212,405	\$ 4,792	\$ 526	\$ 2,000	\$ 219,723

During the three months ended September 30, 2012, there were no transfers between Levels

	For the three months ended September 30, 2011			
	Debt Investments	Warrant Investments	Equity Investments	Total
Level 3 assets, beginning of period	\$ 180,110	\$ 4,360	\$ 668	\$ 185,138
Purchase of investments	7,000	—	—	7,000
Warrants received and classified as Level 3	—	47	—	47
Principal payments received on investments	(12,874 )	—	—	(12,874 )
Net realized loss on investments	—	(17 )	—	(17 )
Unrealized (depreciation) appreciation on investments	(282 )	645	—	363
Other	448	—	(144 )	304
Level 3 assets, end of period	\$ 174,402	\$ 5,035	\$ 524	\$ 179,961

The following tables show a reconciliation of the beginning and ending balances for Level 3 assets for the nine months ended September 30, 2012 and 2011:

	For the nine months ended September 30, 2012				Total
	Debt Investments	Warrant Investments	Equity Investments	Other Investments	
Level 3 assets, beginning of period	\$ 173,286	\$ 4,048	\$ 526	\$ —	\$ 177,860
Purchase of investments	86,720	—	—	—	86,720
Warrants received and classified as Level 3	—	937	—	—	937
Principal payments received on investments	(44,186 )	—	—	—	(44,186 )
Unrealized (depreciation) appreciation included in earnings	(872 )	85	—	—	(787 )
Transfer out of Level 3	—	(278 )	—	—	(278 )
Transfer from debt to other investments	(2,000 )	—	—	2,000	—
Other	(543 )	—	—	—	(543 )
Level 3 assets, end of period	\$ 212,405	\$ 4,792	\$ 526	\$ 2,000	\$ 219,723

The Company's transfers between levels are recognized at the end of the reporting period. During the nine months ended September 30, 2012, there were no transfers between Level 1 and Level 2. The transfer out of Level 3 relates to warrants held in two portfolio companies, with a value of \$0.3 million, that were transferred into Level 2 due to the portfolio companies becoming public companies during the nine months ended September 30, 2012. Because the fair value of the portfolio company warrants held are determined based on inputs that are readily available in public markets or can be derived from information available in public markets, the Company has categorized the warrants as Level 2 within the fair value hierarchy described above as of September 30, 2012.

**Horizon Technology Finance Corporation and Subsidiaries****Notes to Consolidated Financial Statements****(In thousands, except shares and per share data)**

	For the nine months ended September 30, 2011			
	Debt Investments	Warrant Investments	Equity Investments	Total
Level 3 assets, beginning of period	\$ 130,234	\$ 4,249	\$ 142	\$ 134,625
Purchase of investments	78,156	—	—	78,156
Warrants and equity received and classified as Level 3	—	1,040	482	1,522
Principal payments received on investments	(32,574 )	—	—	(32,574 )
Proceeds from sale of investments	—	(3,971 )	—	(3,971 )
Net realized gain on investments	—	3,938	—	3,938
Unrealized (depreciation) appreciation on investments	(681 )	(221 )	44	(858 )
Other	(733 )	—	(144 )	(877 )
Level 3 assets, end of period	\$ 174,402	\$ 5,035	\$ 524	\$ 179,961

The change in unrealized appreciation (depreciation) included in the consolidated statement of operations attributable to Level 3 investments still held at September 30, 2012 includes \$0.9 million depreciation on loans and \$0.1 million appreciation on warrants.

The Company discloses fair value information about financial instruments, whether or not recognized in the statement of assets and liabilities, for which it is practicable to estimate that value. Certain financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The fair value amounts have been measured as of the reporting date, and have not been reevaluated or updated for purposes of these financial statements subsequent to that date. As such, the fair values of these financial instruments subsequent to the reporting date may be different than amounts reported.

As of September 30, 2012 and December 31, 2011, the recorded book balances approximated fair value for all of the Company's financial instruments that are not recognized at fair value.

*Off-balance sheet instruments*

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and by investing in securities with terms that mitigate the Company's overall interest rate risk.

**Note 6. Borrowings**

In accordance with the 1940 Act, with certain limited exceptions, the Company is only allowed to borrow amounts such that the asset coverage, as defined in the 1940 Act, is at least 200% after such borrowings. As of September 30, 2012, the asset coverage for borrowed amounts was 300%.

The Company entered into a revolving credit facility (the "WestLB Facility") with WestLB, AG, New York Branch ("WestLB") effective March 4, 2008. The WestLB Facility had a three year initial revolving term and on March 3, 2011, the revolving term ended. The outstanding principal balance of the WestLB Facility is amortizing based on loan investment payments received through March 3, 2015. The interest rate is based upon the one-month LIBOR (0.21% as of September 30, 2012 and 0.30% as of December 31, 2011) plus a spread of 2.50%. The rates at September 30, 2012 and December 31, 2011 were 2.71% and 2.80%, respectively. The average rates for the three months ended September 30, 2012 and 2011 were 2.79%, and 2.76%, respectively. The average rates for the nine months ended September 30, 2012 and 2011 were 2.79% and 2.78%, respectively.



## Horizon Technology Finance Corporation and Subsidiaries

### Notes to Consolidated Financial Statements

(In thousands, except shares and per share data)

The WestLB Facility is collateralized by all loans and warrants held by Credit I and permits an advance rate of up to 75% of eligible loans held by Credit I. The WestLB Facility contains covenants that, among other things, require the Company to maintain a minimum net worth and to restrict the loans securing the WestLB Facility to certain criteria for qualified loans, and includes portfolio company concentration limits as defined in the related loan agreement. The average amounts of borrowings were approximately \$12.0 million and \$69.5 million for the three months ended September 30, 2012 and 2011, respectively. The average amounts of borrowings were approximately \$23.6 million and \$78.1 million for the nine months ended September 30, 2012 and 2011, respectively. At September 30, 2012 and December 31, 2011, the Company had actual borrowings outstanding of approximately \$9.6 million and \$46.7 million, respectively, on the WestLB Facility.

The Company entered into a revolving credit facility (the "Wells Facility") with Wells Fargo Capital Finance, LLC ("Wells") effective July 14, 2011. The Wells Facility has an accordion feature which allows for an increase in the total loan commitment to \$150 million from the current \$75 million commitment provided by Wells. The Wells Facility has a three year revolving term followed by a three year amortization period and matures on July 14, 2017. The interest rate is based upon the one-month LIBOR plus a spread of 4.00%, with a LIBOR floor of 1.00%. The rate at both September 30, 2012 and 2011 was 5.00%. The average rate for both the three months ended September 30, 2012 and 2011 was 5.00%. The average rate for the nine months ended September 30, 2012 was 5.00%.

The Wells Facility is collateralized by all loans and warrants held by Credit II and permits an advance rate of up to 50% of eligible loans held by Credit II. The Wells Facility contains covenants that, among other things, require the Company to maintain a minimum net worth and to restrict the loans securing the Wells Facility to certain criteria for qualified loans and includes portfolio company concentration limits as defined in the related loan agreement. The average amount of borrowings were approximately \$9.9 million and \$15.1 million for the three months ended September 30, 2012 and 2011, respectively. The average amount of borrowings were approximately \$11.7 million for the nine months ended September 30, 2012. The average rate and average borrowings for the nine months ended September 30, 2011 are not meaningful because the Wells Facility was outstanding for only a short duration during that period. At September 30, 2012 and December 31, 2011, the Company had actual borrowings outstanding of approximately \$23.7 million and \$17.8 million on the Wells Facility.

On March 23, 2012, the Company issued and sold an aggregate principal amount of \$30 million of 7.375% senior unsecured notes due in 2019 and on April 18, 2012, pursuant to the underwriters' 30 day option to purchase additional notes, the Company sold an additional \$3 million of such notes (collectively, the "Senior Notes"). The Senior Notes will

mature on March 15, 2019 and may be redeemed in whole or in part at the Company's option at any time or from time to time on or after March 15, 2015 at a redemption price of \$25 per security plus accrued and unpaid interest. The Senior Notes bear interest at a rate of 7.375% per year payable quarterly on March 15, June 15, September 15 and December 15 of each year. The Senior Notes are the Company's direct unsecured obligations and rank (i) pari passu with the Company's future senior unsecured indebtedness; (ii) senior to any of the Company's future indebtedness that expressly provides it is subordinated to the Senior Notes; (iii) effectively subordinated to all of the Company's existing and future secured indebtedness (including indebtedness that is initially unsecured to which we subsequently grant security) to the extent of the value of the assets securing such indebtedness and (iv) structurally subordinated to all existing and future indebtedness and other obligations of any of the Company's subsidiaries. The Senior Notes are listed on the New York Stock Exchange under the symbol "HTF."

The Company entered into a term loan credit facility (the "Fortress Facility") with Fortress Credit Co LLC effective August 23, 2012. The Fortress Facility contains covenants that, among other things, require the Company to maintain a minimum net worth and to restrict the loans securing the Fortress Facility to certain criteria for qualified loans and includes portfolio company concentration limits as defined in the related loan agreement. The Fortress Facility, among other things, has a three-year term subject to two one-year extensions with a draw period of up to four years. The Fortress Facility requires the payment of an unused line fee of 1.00% annually beginning October 1, 2012 and has an effective advance rate of approximately 66% against eligible loans. The Fortress Facility generally bears interest based upon the one-month LIBOR plus a spread of 6.00%, with a LIBOR floor of 1.00%. The rate at September 30, 2012 was 7.00%, and the average rate for the period within the three months ended September 30, 2012, in which the loan was outstanding, was 7.00%. The average amount of borrowings was approximately \$10.0 million for the period within the three months ended September 30, 2012 in which the loan was outstanding. The average rate and average borrowings for the nine months ended September 30, 2012 is not meaningful because the Fortress Facility was outstanding for only a short duration during that period. At September 30, 2012, the Company had actual borrowings outstanding of approximately \$10.0 million on the Fortress Facility.

#### **Note 7. Financial Instruments with Off-Balance Sheet Risk**

In the normal course of business, the Company is party to financial instruments with off-balance sheet risk to meet the financing needs of its borrowers. These financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated statements of assets and liabilities. The Company attempts to limit its credit risk by conducting extensive due diligence and obtaining collateral where appropriate.

## **Horizon Technology Finance Corporation and Subsidiaries**

### **Notes to Consolidated Financial Statements**

**(In thousands, except shares and per share data)**

The balance of unfunded commitments to extend credit was approximately \$29.0 million and \$22.5 million as of September 30, 2012 and December 31, 2011, respectively. Commitments to extend credit consist principally of the unused portions of commitments that obligate the Company to extend credit, such as revolving credit arrangements or similar transactions. Commitments may also include a financial or non-financial milestone that has to be achieved before the commitment can be drawn. Commitments generally have fixed expiration dates or other termination clauses. Since commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

#### **Note 8. Concentrations of Credit Risk**

The Company's loan portfolio consists primarily of loans to development-stage companies at various stages of development in the technology, life science, healthcare information and services and cleantech industries. Many of these companies may have relatively limited operating histories and also may experience variation in operating results. Many of these companies conduct business in regulated industries and could be affected by changes in government regulations. Most of the Company's borrowers will need additional capital to satisfy their continuing working capital needs and other requirements and, in many instances, to service the interest and principal payments on the loans.

The largest loans may vary from year to year as new loans are recorded and repaid. The Company's five largest loans represented approximately 25% and 28% of total loans outstanding as of September 30, 2012 and December 31, 2011, respectively. No single loan represents more than 10% of the total loans as of September 30, 2012 and December 31, 2011. Loan income, consisting of interest and fees, can fluctuate significantly upon repayment of large loans. Interest income from the five largest loans accounted for approximately 23% and 27% of total loan interest and fee income for the three months ended September 30, 2012 and 2011, respectively. Interest income from the five largest loans accounted for approximately 23% and 25% of total loan interest and fee income for the nine months ended September 30, 2012 and 2011, respectively.

#### **Note 9: Interest Rate Swaps and Hedging Activities**

On October 14, 2008, the Company entered into two interest rate swap agreements (collectively, the “Swap”) with WestLB, fixing the rate of \$10 million at 3.58% and \$15 million at 3.20% on the first advances of a like amount of variable rate WestLB Facility borrowings. The \$15 million interest rate swap expired in October 2010 and the \$10 million interest rate swap expired in October 2011. The objective of the Swap was to hedge the risk of changes in cash flows associated with the future interest payments on the first \$25 million of the variable rate WestLB Facility debt with a combined notional amount of \$25 million.

During the nine months ended September 30, 2011, approximately \$245 of net unrealized appreciation, and approximately \$255 of net realized losses, from the Swap were recorded in the statement of operations.

**Note 10: Dividends and Distributions**

The Company’s dividends and distributions are recorded on the record date. The following table summarizes the Company’s dividend declaration and distribution activity as of September 30, 2012:

Date Declared	Record Date	Payment Date	Amount Per Share	Cash Distribution	Drip Shares Issued	Drip Shares Values
12/15/10	12/28/10	12/31/10	\$ 0.22	\$ 1,097	38,297	\$ 565
5/10/11	5/19/11	5/26/11	\$ 0.33	\$ 2,190	20,104	\$ 316
8/9/11	8/23/11	8/30/11	\$ 0.40	\$ 2,836	13,193	\$ 209
11/8/11	11/23/11	11/30/11	\$ 0.45	\$ 3,281	9,814	\$ 151
3/12/12	3/23/12	3/30/12	\$ 0.45	\$ 3,378	3,517	\$ 58
5/3/12	5/17/12	5/31/12	\$ 0.45	\$ 3,402	2,299	\$ 37
8/7/12	8/17/12	8/31/12	\$ 0.45	\$ 4,105	11,608	\$ 193

On November 2, 2012, the Company declared a third quarter dividend of \$0.45 per share, payable on November 30, 2012 to stockholders of record on November 16, 2012.

**Horizon Technology Finance Corporation and Subsidiaries****Notes to Consolidated Financial Statements****(In thousands, except shares and per share data)****Note 11: Financial Highlights**

The financial highlights for the Company are as follows:

	For the nine months ended September 30,			
	2012		2011	
Per share data:				
Net asset value at beginning of period	\$17.01		\$16.75	
Net dilution from issuance of common stock	(0.28	)	—	
Dividend declared and distributed	(1.35	)	(0.73	)
Net investment income	1.06		0.95	
Realized (loss) gain on investments	(0.01	)	0.73	
Unrealized depreciation on investments	(0.02	)	(0.34	)
Net asset value at end of period	\$16.41		\$17.36	
Per share market value, end of period	\$16.16		\$14.66	
Total return based on market value	7.3	%	6.6	%
Shares outstanding at end of period	9,562,956		7,626,718	
Ratios to average net assets:				
Expenses without incentive fees	8.0	%(1)	8.2	%(1)
Incentive fees	2.0	%(1)	2.8	%(1)
Total expenses	10.0	%(1)	11.0	%(1)
Net investment income with incentive fees	8.4	%(1)	10.2	%(1)
Average net assets	\$135,934		\$129,786	
Portfolio turnover ratio	48.33	%	48.06	%

(1) Annualized.

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

*In this section, except where the context suggests otherwise, the terms "we," "us," "our" and "Horizon Technology Finance" refer to Horizon Technology Finance Corporation and its consolidated subsidiaries. The information contained in this section should be read in conjunction with our consolidated financial statements and related notes thereto appearing elsewhere in this quarterly report on Form 10-Q. Amounts are stated in thousands, except shares and per share data and where otherwise noted.*

### **Overview**

We are a specialty finance company that lends to and invests in development-stage companies in the technology, life science, healthcare information and services and cleantech industries, which we refer to as our "Target Industries." Our investment objective is to generate current income from the loans we make and capital appreciation from the warrants we receive when making such loans. We make secured loans, which we refer to as "Venture Loans," to companies backed by established venture capital and private equity firms in our Target Industries, which we refer to as "Venture Lending." We also selectively lend to publicly traded companies in our Target Industries.

We are an externally managed, closed-end, non-diversified management investment company that has elected to be regulated as a BDC under the 1940 Act. As a BDC, we are required to comply with regulatory requirements, including limitations on our use of debt. We are permitted to, and expect to, finance our investments through borrowings. However, as a BDC, we are only generally allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. The amount of leverage that we employ depends on our assessment of market conditions and other factors at the time of any proposed borrowing.

Compass Horizon Funding Company LLC ("Compass Horizon") our predecessor company, commenced operations in March 2008. We were formed in March 2010 for the purpose of acquiring Compass Horizon and continuing its business as a public entity.

### **Portfolio Composition and Investment Activity**

The following table shows our portfolio composition by asset class as of September 30, 2012 and December 31, 2011:

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

	September 30, 2012			December 31, 2011		
	# of Investments	Fair Value	% of Total Portfolio	# of Investments	Fair Value	% of Total Portfolio
Term loans	39	\$191,612	86.7 %	37	\$172,363	96.8 %
Revolving loans	4	20,733	9.4 %	—	—	0.0 %
Equipment loans	1	60	0.1 %	1	923	0.5 %
Total loans	44	212,405	96.2 %	38	173,286	97.3 %
Warrants	58	5,827	2.6 %	47	4,098	2.3 %
Other investments	1	2,000	0.9 %	—	—	0.0 %
Equity	2	677	0.3 %	3	629	0.4 %
Total		\$220,909	100.0 %		\$178,013	100.0 %

Total portfolio investment activity for the periods ended September 30, 2012 and 2011 was as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Beginning portfolio	\$ 195,600	\$ 186,029	\$ 178,013	\$ 136,810
New loan funding	48,464	7,000	117,459	86,833
Less refinanced balances	(12,000 )	—	(30,739 )	(8,677 )
Net new loan funding	36,464	7,000	86,720	78,156
Principal payments received on investments	(10,607 )	(8,559 )	(28,522 )	(22,666 )
Early pay-offs	(1,459 )	(4,315 )	(15,664 )	(9,908 )
Accretion of loan fees	606	527	1,698	1,356
New loan fees	(372 )	(40 )	(1,120 )	(967 )
New equity	—	—	—	577
Proceeds from sale of investments	—	—	(38 )	—
Net realized loss on investments	—	—	(61 )	—
Net appreciation (depreciation) on investments	677	(456 )	(117 )	(3,172 )
Ending portfolio	\$ 220,909	\$ 180,186	\$ 220,909	\$ 180,186

We receive payments in our loan portfolio based on scheduled amortization of the outstanding balances. In addition, we receive repayments of some of our loans prior to their scheduled maturity date. The frequency or volume of these repayments may fluctuate significantly from period to period.

The following table shows our debt investments by industry sector as of September 30, 2012 and December 31, 2011:

	September 30, 2012		December 31, 2011		
	Loans at Fair Value	Percentage of Total Portfolio	Loans at Fair Value	Percentage of Total Portfolio	
Life Science					
Biotechnology	\$ 48,624	22.9	% \$ 39,854	23.0	%
Medical Device	18,812	8.9	% 19,281	11.1	%
Technology					
Consumer-Related Technologies	—	—	1,762	1.0	%
Networking	60	0.1	% 923	0.5	%
Software	26,529	12.5	% 23,354	13.5	%
Data Storage	—	—	3,437	2.0	%
Internet and Media	9,729	4.6	% —	—	
Communications	—	—	5,134	3.0	%
Semiconductors	19,765	9.3	% 11,765	6.8	%
Power Management	15,773	7.4	% —	—	



Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

Cleantech						
Energy Efficiency	27,899	13.1	%	23,790	13.7	%
Waste Recycling	3,602	4.0	%	4,455	2.6	%
Alternative Energy	8,559	1.7	%	—	—	
Healthcare Information and Services						
Diagnostics	18,282	8.6	%	21,347	12.3	%
Other Healthcare Related Services	14,771	6.9	%	18,184	10.5	%
Total	\$ 212,405	100.0	%	\$ 173,286	100.0	%

The largest loans may vary from year to year as new loans are recorded and repaid. Our five largest loans represented approximately 25% and 28% of total loans outstanding as of September 30, 2012 and December 31, 2011, respectively. No single loan represented more than 10% of our total loans as of September 30, 2012 and December 31, 2011.

**Loan Portfolio Asset Quality**

We use a credit rating system which rates each loan on a scale of 4 to 1, with 4 being the highest credit quality rating and 3 being the rating for a standard level of risk. A rating of 2 or 1 represents a deteriorating credit quality and increased risk. The following table shows the classification of our loan portfolio by credit rating as of September 30, 2012 and December 31, 2011:

Credit Rating	September 30, 2012		December 31, 2011		
	Loans at Fair Value	Percentage of Loan Portfolio	Loans at Fair Value	Percentage of Loan Portfolio	
4	\$ 43,562	20.5	% \$ 30,108	17.4	%
3	153,247	72.2	% 119,753	69.1	%
2	15,596	7.3	% 23,425	13.5	%
1	—	—	—	—	
Total	\$ 212,405	100.0	% \$ 173,286	100.0	%

As of September 30, 2012 and December 31, 2011, our loan portfolio had a weighted average credit rating of 3.2 and 3.1, respectively. There were no loans on non-accrual status as of September 30, 2012 and December 31, 2011. Subsequent to September 30, 2012, one loan with a credit rating of “2” and a cost and fair value of approximately \$5.2 million was placed on non-accrual status.

**Consolidated Results of Operations for the three months ended September 30, 2012 and 2011**

Consolidated operating results for the three months ended September 30, 2012 and 2011 are as follows:

	For the three months ended	
	September 30, 2012	2011
Total investment income	\$ 6,619	\$ 6,441
Total expenses	3,650	3,448
Net investment income	2,969	2,993
Net realized losses	—	(17 )
Net unrealized appreciation (depreciation)	677	(217 )
Net increase in net assets resulting from operations	\$ 3,646	\$ 2,759
Average debt investments, at fair value	\$ 195,147	\$ 180,951
Average borrowings outstanding	\$ 59,112	\$ 80,871

Net increase in net assets resulting from operations can vary substantially from period to period for various reasons, including the recognition of realized gains and losses and unrealized appreciation and depreciation. As a result, quarterly comparisons of net increase in net assets resulting from operations may not be meaningful.

### ***Investment Income***

Investment income increased by \$0.2 million, or 2.8%, for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011. For the three months ended September 30, 2012, total investment income consisted primarily of \$6.4 million in interest income from investments, which included \$1.1 million in income from the amortization of origination fees and end-of-term payments on investments. Interest income on investments increased primarily due to the increased average balance of the loan portfolio. Fee income on investments was primarily comprised of prepayment fees from our portfolio companies. For the three months ended September 30, 2011, total investment income consisted primarily of \$6.1 million in interest income from investments, which included \$0.9 million in income from the amortization of origination fees and end-of-term payments on investments.

For the three months ended September 30, 2012 and 2011, our dollar-weighted average annualized yield on average loans was approximately 13.6% and 14.2%, respectively. Investment income, consisting of interest income and fees on loans, can fluctuate significantly upon repayment of large loans. Interest income from the five largest loans accounted for approximately 23% and 27% of investment income for the three months ended September 30, 2012 and 2011, respectively.

As of September 30, 2012 and December 31, 2011, interest receivable was \$4.1 million and \$3.0 million, respectively, which represents one month of accrued interest income on substantially all our loans and end of term payments on a portion of our loans.

### *Expenses*

Total expenses increased by \$0.2 million, or 5.9%, to \$3.7 million for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011. Total operating expenses for each period consisted principally of interest expense, management fees, incentive and administrative fees and, to a lesser degree, professional fees and general and administrative expenses.

Interest expense, which includes the amortization of debt issuance costs, increased for the three months ended September 30, 2012 compared to the three months ended September 30, 2011 primarily due to an increase in borrowings under the Wells Facility and the Fortress Facility, and the issuance of our Senior Notes, offset by continued pay down under the WestLB Facility.

Management fee expense for the three months ended September 30, 2012 remained flat compared to the three months ended September 30, 2011. Performance based incentive fees increased by \$0.2 million primarily due to the reversal of an accrual for the incentive fee related to realized gains in the three months ended September 30, 2011, with no such reversal recorded at September 30, 2012.

Professional fees and general and administrative expenses primarily include legal and audit fees and insurance premiums. These expenses were \$0.4 million and \$0.7 million for the three months ended September 30, 2012 and 2011, respectively.

### *Net Realized Gains and Net Unrealized Appreciation and Depreciation*

Realized gains or losses on investments are measured by the difference between the net proceeds from the repayment or sale and the cost basis of our investments without regard to unrealized appreciation or depreciation previously recognized and includes investments charged off during the period, net of recoveries. The net change in unrealized appreciation or depreciation on investments primarily reflects the change in portfolio investment fair values during the reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains or losses are realized.

During the three months ended September 30, 2012, net unrealized appreciation on investments totaled approximately \$0.7 million. For the three months ended September 30, 2011, net unrealized depreciation on investments totaled approximately \$0.2 million. For both periods the change was primarily due to the change in the fair values of our investment portfolio during each period.

**Consolidated Results of Operations for the nine months ended September 30, 2012 and 2011**

Consolidated operating results for the nine months ended September 30, 2012 and 2011 are as follows:

	For the nine months ended	
	September 30,	
	2012	2011
Total investment income	\$ 18,726	\$ 17,871
Total expenses	10,146	10,670
Net investment income	8,580	7,201
Net realized (losses) gains	(61 )	5,544
Net unrealized depreciation	(117 )	(2,535 )
Net increase in net assets resulting from operations	\$ 8,402	\$ 10,210
Average debt investments, at fair value	\$ 179,417	\$ 162,623
Average borrowings outstanding	\$ 59,886	\$ 82,606

Net increase in net assets resulting from operations can vary substantially from period to period for various reasons, including the recognition of realized gains and losses and unrealized appreciation and depreciation. As a result, quarterly comparisons of net increase in net assets resulting from operations may not be meaningful.

***Investment Income***

Investment income increased by \$0.9 million, or 4.8%, for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011. For the nine months ended September 30, 2012, total investment income consisted primarily of \$17.8 million in interest income from investments, which included \$3.1 million in income from the amortization of origination fees and end-of-term payments on investments. Interest income on investments increased primarily due to the increased average balance of the loan portfolio. Fee income on investments for the nine months ended September 30, 2012 was primarily from prepayment fees from our portfolio companies. For the nine months ended September 30, 2011, total investment income consisted primarily of \$16.9 million in interest income from investments, which included \$2.5 million in income from the amortization of origination fees and end-of-term payments on investments. Fee income on investments for the nine months ended September 30, 2011 was primarily comprised of a one-time success fee received upon the completion of an acquisition of one of our portfolio companies.

For the nine months ended September 30, 2012 and 2011, our dollar-weighted average annualized yield on average loans was approximately 13.9% and 14.6% respectively. Investment income, consisting of interest income and fees on loans, can fluctuate significantly upon repayment of large loans. Interest income from the five largest loans accounted for approximately 23% and 25% of investment income for the nine months ended September 30, 2012 and 2011, respectively.

### ***Expenses***

Total expenses decreased by \$0.5 million, or 4.9%, to \$10.1 million for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011. Total operating expenses for each period consisted principally of interest expense, management fees, incentive and administrative fees and, to a lesser degree, professional fees and general and administrative expenses.

Interest expense, which includes the amortization of debt issuance costs, increased for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011 primarily due to an increase in borrowings under the Wells Facility and the Fortress Facility, and the issuance of our Senior Notes, offset by continued pay down under the WestLB Facility.

Management fee expense for the nine months ended September 30, 2012 decreased compared to the nine months ended September 30, 2011 as a result of a decrease in average gross assets as we deleveraged our portfolio. Performance based incentive fees decreased by \$0.7 million primarily due to the recording of an accrual for the incentive fee related to realized gains earned in the nine months ended September 30, 2011, with no such accrual recorded at September 30, 2012.

Professional fees and general and administrative expenses primarily include legal and audit fees and insurance premiums. These expenses were \$1.5 million and \$1.8 million for the nine months ended September 30, 2012 and 2011, respectively.

### ***Net Realized Gains and Net Unrealized Appreciation and Depreciation***

Realized gains or losses on investments are measured by the difference between the net proceeds from the repayment or sale and the cost basis of our investments without regard to unrealized appreciation or depreciation previously recognized and includes investments charged off during the period, net of recoveries. The net change in unrealized appreciation or depreciation on investments primarily reflects the change in portfolio investment fair values during the

reporting period, including the reversal of previously recorded unrealized appreciation or depreciation when gains or losses are realized.

During the nine months ended September 30, 2012, we recognized realized losses of approximately \$0.1 million primarily due to the charge off of warrants in one portfolio company. During the nine months ended September 30, 2011, we recognized realized gains of approximately \$5.5 million primarily due to the sale of warrants in four portfolio companies.

During the nine months ended September 30, 2012, net unrealized depreciation on investments totaled approximately \$0.1 million which was primarily due to the change in fair values of our investment portfolio during the period. For the nine months ended September 30, 2011, net unrealized depreciation on investments totaled approximately \$2.5 million which was primarily due to the reversal of previously recorded unrealized appreciation on our warrant investments that were realized in the period, offset by a net increase in the fair value of our investments.

### **Liquidity and Capital Resources**

As of September 30, 2012 and December 31, 2011, we had cash and investments in money market funds of \$5.7 million and \$14.8 million, respectively. These amounts are available to fund new investments, reduce borrowings under the WestLB Facility, Wells Facility, and the Fortress Facility (collectively, the "Credit Facilities"), pay operating expenses and pay dividends. Our primary sources of capital have been from our private and public common stock offerings, use of our Credit Facilities and issuance of our Senior Notes.

The WestLB Facility had a three year initial revolving term which ended on March 3, 2011. The outstanding principal balance under the WestLB Facility was \$9.6 million as of September 30, 2012 and is amortizing based on debt investment payments received through March 3, 2015.

As of September 30, 2012, the outstanding principal balance under the Wells Facility was \$23.7 million. As of September 30, 2012, we had available borrowing capacity of approximately \$51.3 million under our Wells Facility, subject to existing terms and advance rates.

As of September 30, 2012, the outstanding principal balance under the Fortress Facility was \$10.0 million. As of September 30, 2012, we had available borrowing capacity of approximately \$65.0 million under our Fortress Facility, subject to existing terms and advance rates.

Our operating activities used cash of \$25.3 million for the nine months ended September 30, 2012 and our financing activities provided net cash proceeds of \$27.3 million for the same period. Our operating activities used cash primarily for investing in portfolio companies. Our financing activities provided cash primarily from the issuance of our Senior Notes of \$33.0 million, and the completion of a follow-on public offering of 1.9 million shares of common stock for proceeds of approximately \$29.5 million, after deducting offering expenses.

Our operating activities used cash of \$22.1 million for the nine months ended September 30, 2011 and our financing activities used cash of \$11.8 million for the same period. Our operating activities used cash primarily for investing in portfolio companies and that cash was provided primarily from our initial public offering and draws under the Wells Facility and WestLB Facility.

Our primary use of available funds is to make investments in portfolio companies and for general corporate purposes. We expect to opportunistically raise additional equity and debt capital as needed, and subject to market conditions, to support our future growth through future equity offerings, issuances of senior securities and/or future borrowings, to the extent permitted by the 1940 Act.

In order to satisfy the Code requirements applicable to a RIC, we intend to distribute to our stockholders all or substantially all of our income except for certain net capital gains. In addition, as a BDC, we generally will be required to meet a coverage ratio of 200%. This requirement will limit the amount that we may borrow.

### ***Current Borrowings***

We, through our wholly owned subsidiary, Credit I, entered into the WestLB Facility. The base rate borrowings under the WestLB Facility bear interest at one-month LIBOR (0.21% as of September 30, 2012 and 0.30% as of December 31, 2011) plus a spread of 2.50%. The rates were 2.71% and 2.80% as of September 30, 2012 and December 31, 2011, respectively. We were able to request advances under the WestLB Facility through March 4, 2011. We may not request new advances and we must repay the outstanding advances under the WestLB Facility as of such date and at such times and in such amounts as are necessary to maintain compliance with the terms and conditions of the WestLB Facility, particularly the condition that the principal balance of the WestLB Facility does not exceed seventy-five percent (75%) of the aggregate principal balance of our eligible loans to our portfolio companies. All outstanding advances under the WestLB Facility are due and payable on March 4, 2015.



The WestLB Facility is collateralized by all loans and warrants held by Credit I and permits an advance rate of up to 75% of eligible loans held by Credit I. The WestLB Facility contains covenants that, among other things, require the Company to maintain a minimum net worth and to restrict the loans securing the WestLB Facility to certain criteria for qualified loans, and includes portfolio company concentration limits as defined in the related loan agreement.

We, through our wholly owned subsidiary Credit II, entered into the Wells Facility on July 14, 2011. The interest rate on the Wells Facility is based upon the one-month LIBOR plus a spread of 4.00%, with a LIBOR floor of 1.00%. The interest rate was 5.00% as of September 30, 2012 and December 31, 2011.

We may request advances under the Wells Facility through July 14, 2014 (the “Revolving Period”). After the Revolving Period, we may not request new advances and we must repay the outstanding advances under the Wells Facility as of such date, at such times and in such amounts as are necessary to maintain compliance with the terms and conditions of the Wells Facility, particularly the condition that the principal balance of the Wells Facility does not exceed fifty percent (50%) of the aggregate principal balance of our eligible loans to our portfolio companies. All outstanding advances under the Wells Facility are due and payable on July 14, 2017.

The Wells Facility is collateralized by loans held by Credit II and permits an advance rate of up to 50% of eligible loans held by Credit II. The Wells Facility contains covenants that, among other things, require us to maintain a minimum net worth, to restrict the loans securing the Wells Facility to certain criteria for qualified loans and to comply with portfolio company concentration limits as defined in the related loan agreement.

On March 23, 2012, we issued and sold \$30 million aggregate principal amount of 7.375% senior unsecured notes due in 2019 and on April 18, 2012, pursuant to the underwriters’ 30 day option to purchase additional notes, we sold an additional \$3 million of such notes (collectively, the “Senior Notes”). The Senior Notes will mature on March 15, 2019 and may be redeemed in whole or in part at our option at any time or from time to time on or after March 15, 2015 at a redemption price of \$25 per security plus accrued and unpaid interest. The Senior Notes bear interest at a rate of 7.375% per year payable quarterly on March 15, June 15, September 15 and December 15 of each year. The Senior Notes are our direct, unsecured obligations and rank (i) pari passu with our future senior unsecured indebtedness; (ii) senior to any of our future indebtedness that expressly provides it is subordinated to the Senior Notes; (iii) effectively subordinated to all of our existing and future secured indebtedness (including indebtedness that is initially unsecured to which we subsequently grant security), to the extent of the value of the assets securing such indebtedness and (iv) structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries.

We, through our wholly owned subsidiary Credit III, entered into the Fortress Facility on August 23, 2012. The interest rate on the Fortress Facility is based upon the one-month LIBOR plus a spread of 6.00%, with a LIBOR floor of 1.00%. The interest rate was 7.00% as of September 30, 2012.

We may request advances under the Fortress Facility through August 23, 2016 (the “Draw Period”). After the Draw Period, we may not request new advances and we must repay the outstanding advances under the Fortress Facility as of such date, at such times and in such amounts as are necessary to maintain compliance with the terms and conditions of the Fortress Facility, particularly the condition that the principal balance of the Fortress Facility does not exceed approximately sixty-six percent (66%) of the aggregate principal balance of our eligible loans to our portfolio companies. All outstanding advances under the Fortress Facility are due and payable on August 23, 2017.

The Fortress Facility is collateralized by loans held by Credit III and permits an advance rate of up to approximately 66% of eligible loans held by Credit III. The Fortress Facility contains covenants that, among other things, require us to maintain a minimum net worth, to restrict the loans securing the Fortress Facility to certain criteria for qualified loans and to comply with portfolio company concentration limits as defined in the related loan agreement.

As of September 30, 2012 and December 31, 2011, other assets were \$4.7 million and \$2.0 million, respectively, which were comprised primarily of debt issuance costs and prepaid expenses. The increase was due to the debt issuance costs of approximately \$1.3 million and \$1.7 million incurred related to the Senior Notes and Fortress Facility, respectively.

### *Contractual Obligations and Off-Balance Sheet Arrangements*

A summary of our significant contractual payment obligations and off-balance sheet arrangements as of September 30, 2012 are as follows:

Contractual Obligations	Payments due by period			
	Total	Less than 1 year	1 - 3 years	3 - 5 years    After 5 years
Borrowings	\$76,251	9,594	33,657	\$ —\$33,000
Unfunded commitments	29,036	27,036	2,000	— —
Total contractual obligations	\$105,287	36,630	35,657	\$ —\$33,000

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 unfunded commitments may be significant from time to time. As of September 30, 2012, we had unfunded commitments of approximately \$29.0 million. These commitments will be subject to the same underwriting and ongoing portfolio maintenance as are the 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.

In addition to the Credit Facilities and the Senior Notes, we have certain commitments pursuant to our Investment Management Agreement entered into with our Advisor. We have agreed to pay a fee for investment advisory and management services consisting of two components — a base management fee and an incentive fee. Payments under the Investment Management Agreement are equal to (1) a base management fee equal to a percentage of the value of our average gross assets and (2) a two-part incentive fee. We have also entered into a contract with our Advisor to serve as our administrator. Payments under the Administration Agreement are equal to an amount based upon our allocable portion of our Advisor's overhead in performing its obligation under the agreement, including rent, fees, and other expenses inclusive of our allocable portion of the compensation of our chief financial officer and chief compliance officer and their respective staff. See Note 3 to our Consolidated Financial Statements for additional information regarding our Investment Management Agreement and our Administration Agreement.

### *Distributions*

In order to qualify as a RIC and to avoid corporate level tax on the income we distribute to our stockholders, we are required under the Code to distribute at least 90% of our net ordinary income and net short-term capital gains in excess of net long-term capital losses, if any, to our stockholders on an annual basis. Additionally, we must distribute at least 98% of our ordinary income and 98.2% of our capital gain net income on an annual basis and any net ordinary income and net capital gains for preceding years that were not distributed during such years and on which we previously paid no U.S. federal income tax to avoid a U.S. federal excise tax. We intend to distribute quarterly dividends to our stockholders as determined by our Board.

We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of our distributions from time to time. In addition, we may be limited in our ability to make distributions due to the asset coverage requirements applicable to us as a BDC under the 1940 Act. If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including the possible loss of our qualification as a RIC. We cannot assure stockholders that they will receive any distributions.

To the extent our taxable earnings fall below the total amount of our distributions for that fiscal year, a portion of those distributions may be deemed a return of capital to our stockholders for U.S. federal income tax purposes. Thus, the source of a distribution to our stockholders may be the original capital invested by the stockholder rather than our income or gains. Stockholders should read any written disclosure accompanying a dividend payment carefully and should not assume that the source of any distribution is our ordinary income or gains.

We have adopted an “opt out” dividend reinvestment plan for our common stockholders. As a result, if we declare a distribution, then stockholders’ cash distributions will be automatically reinvested in additional shares of our common stock unless a stockholder specifically “opts out” of our dividend reinvestment plan. If a stockholder opts out, that stockholder will receive cash distributions. Although distributions paid in the form of additional shares of our common stock will generally be subject to U.S. federal, state and local taxes in the same manner as cash distributions, stockholders participating in our dividend reinvestment plan will not receive any corresponding cash distributions with which to pay any such applicable taxes.

### **Critical Accounting Policies**

The discussion of our financial condition and results of operation is based upon our financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles, or “GAAP.” The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Changes in the economic environment, financial markets and any other parameters used in determining such estimates could cause actual results to differ. In addition to the discussion below, we describe our significant accounting policies in the notes to our consolidated financial statements.

We have identified the following items as critical accounting policies.

### ***Valuation of Investments***

Investments are recorded at fair value. Our Board determines the fair value of its portfolio investments. We apply fair value to substantially all of our investments in accordance with relevant GAAP, which establishes a framework used to measure fair value and requires disclosures for fair value measurements. We have categorized our investments carried at fair value, based on the priority of the valuation technique, into a three-level fair value hierarchy. Fair value is a market-based measure considered from the perspective of the market participant who holds the financial instrument rather than an entity specific measure. Therefore, when market assumptions are not readily available, our own assumptions are set to reflect those that management believes market participants would use in pricing the financial instrument at the measurement date.

The availability of observable inputs can vary depending on the financial instrument and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new, whether the product is traded on an active exchange or in the secondary market and the current market conditions. To the extent that the valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. The three categories within the hierarchy are as follows:

**Level 1** Quoted prices in active markets for identical assets and liabilities.

**Level 2** Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active and model-based valuation techniques for which all significant inputs are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

**Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

### ***Income Recognition***

Interest on loan investments is accrued and included in income based on contractual rates applied to principal amounts outstanding. Interest income is determined using a method that results in a level rate of return on principal amounts outstanding. When a loan becomes 90 days or more past due, or if we otherwise do not expect to receive interest and principal repayments, the loan is placed on non-accrual status and the recognition of interest income is discontinued. Interest payments received on loans that are on non-accrual status are treated as reductions of principal until the principal is repaid.

We receive a variety of fees from borrowers in the ordinary course of conducting our business, including advisory fees, commitment fees, amendment fees, non-utilization fees and prepayment fees. In a limited number of cases, we may also receive a non-refundable deposit earned upon the termination of a transaction. Loan origination fees, net of certain direct origination costs, are deferred, and along with unearned income, are amortized as a level yield adjustment over the respective term of the loan. Fees for counterparty loan commitments with multiple loans are allocated to each loan based upon each loan's relative fair value. When a loan is placed on non-accrual status, the amortization of the related fees and unearned income is discontinued until the loan is returned to accrual status.

Certain loan agreements also require the borrower to make an end-of-term payment that is accrued into income over the life of the loan to the extent such amounts are expected to be collected. We will generally cease accruing the income if there is insufficient value to support the accrual or if we do not expect the borrower to be able to pay all principal and interest due.

In connection with substantially all lending arrangements, we receive warrants to purchase shares of stock from the borrower. The warrants are recorded as assets at estimated fair value on the grant date using the Black-Scholes valuation model. The warrants are considered loan fees and are also recorded as unearned loan income on the grant date. The unearned income is recognized as interest income over the contractual life of the related loan in accordance with our income recognition policy. Subsequent to loan origination, the warrants are also measured at fair value using the Black-Scholes valuation model. Any adjustment to fair value is recorded through earnings as net unrealized gain or loss on warrants. Gains from the disposition of the warrants or stock acquired from the exercise of warrants are recognized as realized gains on warrants.

### ***Income taxes***

We have elected to be treated as a RIC under subchapter M of the Code and operate in a manner so as to qualify for the tax treatment applicable to RICs. In order to qualify as a RIC, among other things, we are required to meet certain source of income and asset diversification requirements and we must timely distribute to our stockholders at least 90%

of investment company taxable income, as defined by the Code, for each year. We, among other things, have made and intend to continue to make the requisite distributions to our stockholders, which will generally relieve us from U.S. federal income taxes.

Depending on the level of taxable income earned in a tax year, we may choose to carry forward taxable income in excess of current year dividend distributions into the next tax year and pay a 4% excise tax on such income, as required. To the extent that we determine that our estimated current year annual taxable income will be in excess of estimated current year dividend distributions, we will accrue excise tax, if any, on estimated excess taxable income as taxable income is earned.

We evaluate tax positions taken in the course of preparing our tax returns to determine whether the tax positions are “more-likely-than-not” to be sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold, or uncertain tax positions, would be recorded as a tax expense in the current year. It is our policy to recognize accrued interest and penalties related to uncertain tax benefits in income tax expense. There were no material uncertain tax positions at September 30, 2012 and December 31, 2011.

### **Recently Issued Accounting Standards**

In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRs, (ASU 2011-04). ASU 2011-04 converges the fair value measurement guidance in U.S. GAAP and International Financial Reporting Standards (IFRSs). Some of the amendments clarify the application of existing fair value measurement requirements, while other amendments change a particular principle in existing guidance. In addition, ASU 2011-04 requires additional fair value disclosures. The Company adopted ASU 2011-04 in the quarter ended March 31, 2012.

**Item 3: Quantitative and Qualitative Disclosures About Market Risk.**

We are subject to financial market risks, including changes in interest rates. During the periods covered by our financial statements, the interest rates on the loans within our portfolio were mostly at fixed rates and we expect that our loans in the future will also have primarily fixed interest rates. The initial commitments to lend to our portfolio companies are usually based on a floating LIBOR index and typically have interest rates that are fixed at the time of the loan funding and remain fixed for the term of the loan.

Assuming that the statement of assets and liabilities as of September 30, 2012 was to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates may affect net income by more than 1% over a one-year horizon. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in the credit market, credit quality, size and composition of the assets on the statement of assets and liabilities and other business developments that could affect net increase in net assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the statement above.

While our Senior Notes bear interest at a fixed rate, our Credit Facilities have a floating interest rate provision based on a LIBOR index which resets daily, and we expect that any other credit facilities into which we enter in the future may have floating interest rate provisions. We have used hedging instruments in the past to protect us against interest rate fluctuations and we may use them in the future. Such instruments may include swaps, futures, options and forward contracts. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to the investments in our portfolio with fixed interest rates.

Because we currently fund, and will continue to fund, our investments with borrowings, our net 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 income. In periods of rising interest rates, our cost of funds would increase, which could reduce our net investment income.

**Item 4: Controls and Procedures.**

*(a) Evaluation of Disclosure Controls and Procedures*



As of September 30, 2012, we, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act). Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective and provided reasonable assurance that information required to be disclosed in our periodic SEC filings is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of such possible controls and procedures.

***(b) Changes in Internal Controls Over Financial Reporting.***

There have been no material changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recently completed fiscal quarter, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Part II — Other Information**

**Item 1: Legal Proceedings.**

Neither we nor our Advisor are currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us or against our Advisor.

**Item 1A: Risk Factors.**

In addition to other information set forth in this report, you should carefully consider the "Risk Factors" discussed in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition and/or operating results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially affect our business, financial condition and/or operating results. There have been no material changes during the nine months ended September 30, 2012 to the risk factors discussed in "Item 1A. Risk Factors" in our annual report on Form 10-K for the year ended December 31, 2011.

**Item 2: Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3: Defaults Upon Senior Securities.**

None.

**Item 4: Mine Safety Disclosures.**

Not applicable

**Item 5: Other Information.**

None.

**Item 6: Exhibits.**

**EXHIBIT INDEX**

**Number Description**

10.1 Loan and Security Agreement, dated as of August 23, 2012, by and among Horizon Credit III LLC, as the borrower, the Lenders that are signatories thereto, as the lenders, and Fortress Credit Co LLC, as the administrative agent (Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on August 23, 2012)

10.2 Sale and Servicing Agreement, dated August 23, 2012, by and among Horizon Credit III LLC, as the buyer, Horizon Technology Finance Corporation, as the originator, Horizon Technology Finance Management

Edgar Filing: Horizon Technology Finance Corp - Form 10-Q

LLC, as the servicer, U.S. Bank National Association, as the collateral custodian and back-up servicer, and Fortress Credit Co LLC, as the agent (Incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed on August 23, 2012)

- 31.1 Certifications by Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002\*
- 31.2 Certifications by Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002\*
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*

\* Filed herewith

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

Horizon Technology Finance Corporation

Date: November 6, 2012 By: /s/ Robert D. Pomeroy, Jr.  
Name: Robert D. Pomeroy, Jr.  
Title: Chief Executive Officer and  
Chairman of the Board

Date: November 6, 2012 By: /s/ Christopher M. Mathieu  
Name: Christopher M. Mathieu  
Title: Chief Financial Officer and Treasurer