Horizon Technology Finance Corp
Form 10-Q
November 09, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2011
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 (State or other jurisdiction of incorporation or organization)	27-2114934 (I.R.S. Employer Identification No.)
312 Farmington Avenue Farmington, CT (Address of principal executive offices)	06032 (Zip Code)

Registrant's telephone number, including area code (860) 676-8654
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.001 per share	The NASDAQ Global Market

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 þ 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 þ (Do not check if a smaller reporting company)	Smaller Reporting Company ¨

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

As of November 9, 2011, the Registrant had 7,626,718 shares of common stock, $0.001 par value, outstanding.

HORIZON TECHNOLOGY FINANCE CORPORATION

FORM 10-Q
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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 SBIC;
- 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, 2010 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, 2011	December 31, 2010
ASSETS		
Non-affiliate investments at fair value (cost of $179,651 and $133,494, respectively) (Note 4)	$ 180,186	$ 136,810
Cash and cash equivalents	32,598	76,793
Interest receivable	2,477	1,938
Other assets (Note 2)	1,610	664
Total assets	$ 216,871	$ 216,205
LIABILITIES		
Borrowings (Note 6)	$ 81,885	$ 87,425
Base management fee payable (Note 3)	362	360
Incentive fee payable (Note 3)	1,453	414
Other accrued expenses	792	811
Total liabilities	84,492	89,010
Net assets		
Common stock, par value $0.001 per share, 100,000,000 shares authorized, 7,626,718 shares outstanding as of September 30, 2011 and 7,593,421 shares outstanding as of December 31, 2010	8	8
Paid-in capital in excess of par	124,361	123,836
Accumulated undistributed (distributions in excess of) net investment income	1,507	(143)
Net unrealized appreciation on investments	508	3,043
Net realized gain on investments	5,995	451
Total net assets	132,379	127,195
Total liabilities and net assets	$ 216,871	$ 216,205
Net asset value per common share	$ 17.36	$ 16.75

See Notes to Consolidated Financial Statements

Horizon Technology Finance Corporation and Subsidiaries

Consolidated Statements of Operations (Unaudited)
(In thousands, except share data)

	Post-IPO as a Business Development Company Three Months Ended September 30, 2011	Pre-IPO Prior to Becoming a Business Development Company Three Months Ended September 30, 2010	Post-IPO as a Business Development Company Nine Months Ended September 30, 2011	Pre-IPO Prior to Becoming a Business Development Company Nine Months Ended September 30, 2010
Investment income				
Interest income on non-affiliate investments	$ 6,129	$ 4,955	$ 16,911	$ 12,852
Interest income on cash and cash equivalents	2	25	90	53
Fee income on non-affiliate investments	310	209	870	345
Total investment income	6,441	5,189	17,871	13,250
Expenses				
Interest expense	725	1,189	2,093	3,282
Base management fee (Note 3)	1,091	675	3,229	1,816
Performance based incentive fee (Note 3)	561	—	2,701	—
Administrative fee (Note 3)	355	—	873	—
Professional fees	489	7	1,034	110
General and administrative	227	61	740	164
Total expenses	3,448	1,932	10,670	5,372
Net investment income	2,993	3,257	7,201	7,878
Credit for loan losses	—	320	—	739
Net realized and unrealized gain on investments				
Net realized (loss) gain on investments	(17)	—	5,544	(2)
Net unrealized (depreciation) appreciation on investments	(217)	1,711	(2,535)	1,549
Net realized and unrealized (loss) gain on investments	(234)	1,711	3,009	1,547
Net increase in net assets resulting from operations	$ 2,759	$ 5,288	$ 10,210	$ 10,164
Net investment income per common share (1)	$ 0.39	$ N/A	$ 0.95	$ N/A
Change in net assets per common share (1)	$ 0.36	$ N/A	$ 1.34	$ N/A

Weighted average shares outstanding (1)	7,617,972	N/A	7,604,345	N/A

(1) For the three and nine months ended September 30, 2010, the Company did not have common shares outstanding or an equivalent and, therefore, earnings per share and weighted average shares outstanding information for this period is not provided.

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)

	Members' Capital	Accumulated Other Comprehensive Loss	Common Stock Shares	Common Stock Amount	Paid-In Capital in Excess of Par	Accumulated Undistributed (distributions in excess of) Net Investment Income	Net Unrealized Appreciation on Investments	Net Realized Gain on Investments	Total Net Assets
Balance at December 31, 2009	$ 60,260	$ (768)	—	$ —	$ —	$ —	$ —	$ —	$ 59,492
Comprehensive income:									
Net income	10,164	—	—	—	—	—	—	—	10,164
Unrealized loss on interest rate swaps	—	409	—	—	—	—	—	—	409
Total comprehensive income	—	—	—	—	—	—	—	—	10,573
Balance at September 30, 2010	$ 70,424	$ (359)	—	$ —	$ —	$ —	$ —	$ —	$ 70,065
Balance at December 31, 2010	$ —	$ —	7,593,421	$ 8	$ 123,836	$ (143)	$ 3,043	$ 451	$ 127,195
Net increase in net assets from operations	—	—	—	—	—	7,201	(2,535)	5,544	10,210
Issuance of common stock as stock dividend	—	—	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

See Notes to Consolidated Financial Statements

Horizon Technology Finance Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Post-IPO as a Business Development Company Nine Months Ended September 30, 2011	Pre-IPO Prior to becoming a Business Development Company Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net increase in net assets resulting from operations	$ 10,210	$ 10,164
Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities:		
Credit for loan losses	—	(739)
Amortization of debt issuance costs	227	871
Net realized (gain) loss on investments	(5,799)	2
Net change in unrealized depreciation (appreciation) on investments	2,535	(1,549)
Purchase of investments	(78,156)	(64,608)
Principal payments received on investments	32,574	41,333
Proceeds from sale of investments	5,887	—
Stock received in settlement of fee income	(544)	—
Changes in assets and liabilities:		
Increase in interest receivable	(539)	(498)
Decrease in unearned loan income	(331)	(302)
Decrease (increase) in other assets	247	(251)
Increase in other accrued expenses	226	91
Increase in base management fee payable	2	35
Increase in incentive fee payable	1,039	—
Net cash used in operating activities	(32,422)	(15,451)
Cash flows from financing activities:		
Net (decrease) increase in revolving borrowings	(5,540)	24,778
Dividends paid	(5,026)	—
Capitalized debt issuance costs	(1,207)	—
Net cash (used in) provided by financing activities	(11,773)	24,778
Net (decrease) increase in cash and cash equivalents	(44,195)	9,327
Cash and cash equivalents:		
Beginning of period	76,793	9,892
End of period	$ 32,598	$ 19,219
Cash paid for interest	$ 1,738	$ 2,366

Supplemental non-cash investing and financing activities:		
Warrant investments received & recorded as unearned loan income	$ 1,129	$ 1,212
Receivables resulting from sales of investments	$ 213	$ —
Decrease in interest rate swap liability	$ (245)	$ (409)

See Notes to Consolidated Financial Statements

Horizon Technology Finance Corporation and Subsidiaries

Consolidated Schedule of Investments
September 30, 2011
(In thousands)

Portfolio Company	Sector	Type of Investment(3)	Interest Rate(4)	Maturity	Cost of Investment(6)	Fair Value
Debt Investments						
Debt Investments — Life Science — 41.2%						
ACT Biotech, Inc.	Biotechnology	Term Loan(1)	13.10 %	12/1/2013	$ 905	$ 905
		Term Loan(1)	13.01 %	12/1/2013	905	905
		Term Loan(1)	13.01 %	12/1/2013	1,371	1,371
Ambit Biosciences Corporation	Biotechnology	Term Loan(1)	12.25 %	10/1/2013	5,066	5,066
Anacor Pharmaceuticals, Inc.(5)	Biotechnology	Term Loan(2)	9.41 %	4/1/2015	3,206	3,206
GenturaDx, Inc.	Biotechnology	Term Loan(2)	11.25 %	4/1/2014	1,903	1,903
N30 Pharmaceuticals, LLC	Biotechnology	Term Loan(1)	11.25 %	9/1/2014	2,412	2,412
Pharmasset, Inc.(5)	Biotechnology	Term Loan(1)	12.00 %	1/1/2012	379	379
		Term Loan(1)	12.50 %	10/1/2012	1,453	1,453
Revance Therapeutics, Inc.	Biotechnology	Convertible Note(1)	8.00 %	2/10/2013	62	62
Supernus Pharmaceuticals, Inc.	Biotechnology	Term Loan(2)	11.00 %	8/1/2014	2,947	2,947
Tranzyme, Inc.(5)	Biotechnology	Term Loan(1)	10.75 %	1/1/2014	4,538	4,538
Xcovery Holding Company, LLC	Biotechnology	Term Loan(2)	12.00 %	10/1/2013	1,494	1,494
		Term Loan(2)	12.00 %	7/1/2014	1,477	1,477
Concentric Medical, Inc.	Medical Device	Term Loan(1)	12.04 %	9/1/2013	6,676	6,676
OraMetrix, Inc.	Medical Device	Term Loan(1)	11.50 %	4/1/2014	4,669	4,669
PixelOptics, Inc.	Medical Device	Term Loan(2)	10.75 %	11/1/2014	9,910	9,910
Tengion, Inc.(5)	Medical Device	Term Loan(2)	11.75 %	1/1/2014	4,948	4,588
ViOptix, Inc.	Medical Device	Term Loan(1)	13.55 %	11/1/2011	656	656
Total Debt Investments — Life Science					54,977	54,617
Debt Investments — Technology — 36.2%						
OpenPeak, Inc.	Communications	Term Loan(1)	11.86 %	12/1/2013	6,016	5,647
Starcite, Inc.	Consumer-related Technologies	Term Loan(1)	12.05 %	9/1/2012	1,604	1,604

Tagged, Inc.	Consumer-related Technologies	Term Loan(1)	12.78 %	5/1/2012	671	671
		Term Loan(1)	11.46 %	8/1/2012	300	300
Xtera Communications, Inc.	Semiconductors	Term Loan(2)	11.50 %	12/1/2014	9,739	9,739
Vette Corp.	Data Storage	Term Loan(1)	11.75 %	7/1/2014	4,928	4,928
IntelePeer, Inc.	Networking	Term Loan(1)	12.43 %	4/1/2012	238	238
		Term Loan(1)	12.33 %	6/1/2012	315	315
		Term Loan(1)	12.33 %	10/1/2012	729	729
Construction Software Technologies, Inc.	Software	Term Loan(2)	11.75 %	12/1/2014	3,940	3,940
		Term Loan	11.75 %	6/1/2014	1,969	1,969
Courion Corporation	Software	Term Loan(1)	11.45 %	9/1/2014	6,889	6,889
Recondo Technology, Inc.	Software	Term Loan	11.50 %	4/1/2015	1,923	1,923
Seapass Solutions, Inc.	Software	Term Loan(2)	11.75 %	11/1/2014	4,924	4,924
StreamBase Systems, Inc.	Software	Term Loan(1)	12.51 %	11/1/2013	3,115	3,115
		Term Loan(1)	12.50 %	6/1/2014	960	960
Total Debt Investments — Technology					48,260	47,891
Debt Investments — Cleantech — 22.9%						
Cereplast, Inc.(5)	Waste Recycling	Term Loan(1)	12.00 %	4/1/2014	2,448	2,448
	Waste Recycling	Term Loan(1)	12.00 %	6/1/2014	2,441	2,441
Enphase Energy, Inc.	Energy Efficiency	Term Loan(1)	12.60 %	10/1/2013	5,697	5,697
		Term Loan	10.75 %	4/1/2015	1,968	1,968
		Term Loan	10.75 %	4/1/2015	2,938	2,938
Satcon Technology Corporation(5)	Energy Efficiency	Term Loan(1)	12.58 %	1/1/2014	8,521	8,521
Tigo Energy, Inc.	Energy Efficiency	Term Loan(1)	11.00 %	8/1/2014	3,422	3,422
		Revolver(2)	10.75 % (Prime + 7.50 %)	1/1/2014	2,933	2,933
Total Debt Investments — Cleantech					30,368	30,368

See Notes to Consolidated Financial Statements

Horizon Technology Finance Corporation and Subsidiaries

Consolidated Schedule of Investments
September 30, 2011 — (Continued)
(In thousands)

Portfolio Company	Sector	Type of Investment(3)	Interest Rate(4)	Maturity	Cost of Investment(6)	Fair Value
Debt Investments — Healthcare information and services — 31.4%						
BioScale, Inc.	Diagnostics	Term Loan(1)	12.00 %	8/1/2012	1,351	1,351
		Term Loan(1)	11.51 %	1/1/2014	4,941	4,941
Precision Therapeutics, Inc.	Diagnostics	Term Loan	10.25 %	12/1/2014	6,952	6,952
Radisphere National Radiology Group, Inc.	Diagnostics	Term Loan(1)	12.75 %	1/1/2013	9,340	9,340
Aperio Technologies, Inc.	Other Healthcare	Term Loan	9.64 %	5/1/2015	4,929	4,929
Patientkeeper, Inc.	Other Healthcare	Term Loan	10.50 %	12/1/2014	5,222	5,222
Singulex, Inc.	Other Healthcare	Term Loan(1)	11.00 %	3/1/2014	2,968	2,968
		Term Loan(1)	11.00 %	3/1/2014	1,978	1,978
Talyst, Inc.	Other Healthcare	Term Loan(1)	12.10 %	12/1/2013	1,924	1,924
		Term Loan(1)	12.05 %	12/1/2013	1,921	1,921
Total Debt Investment — Healthcare information and services					41,526	41,526
Total Debt Investments					175,131	174,402
Warrant Investments						
Warrants — Life Science — 1.3%						
ACT Biotech, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	58	67
Ambit Biosciences, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	143	98
Anacor Pharmaceuticals, Inc.(5)	Biotechnology	Common Stock Warrants(2)	—	—	42	22
Anesiva, Inc.(5)	Biotechnology	Common Stock Warrants(1)	—	—	18	—
GenturaDx, Inc.	Biotechnology	Preferred Stock Warrants(2)	—	—	63	60
N30 Pharmaceuticals, LLC	Biotechnology	Preferred Stock Warrants(1)	—	—	59	46
Novalar Pharmaceuticals, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	69	—
Revance Therapeutics, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	224	489
	Biotechnology	Preferred Stock Warrants(2)	—	—	16	15

Supernus Pharmaceuticals, Inc.						
Tranzyme, Inc.(5)	Biotechnology	Common Stock Warrants(1)	—	—	1	—
Concentric Medical, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	84	875
EnteroMedics, Inc.(5)	Medical Device	Common Stock Warrants(1)	—	—	347	2
OraMetrix, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	78	67
PixelOptics, Inc.	Medical Device	Preferred Stock Warrants(2)	—	—	96	46
Tengion, Inc.(5)	Medical Device	Common Stock Warrants(2)	—	—	62	—
ViOptix, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	13	—
Total Warrants — Life Science					1,373	1,787
Warrants — Technology — 1.5%						
OpenPeak, Inc.	Communications	Preferred Stock Warrants(1)	—	—	89	—
Everyday Health, Inc.	Consumer-related technologies	Preferred Stock Warrants(1)	—	—	69	116
SnagAJob.com, Inc.	Consumer-related technologies	Preferred Stock Warrants(1)	—	—	23	270
Starcite, Inc.	Consumer-related technologies	Preferred Stock Warrants(1)	—	—	24	27
Tagged, Inc.	Consumer-related technologies	Preferred Stock Warrants(1)	—	—	17	27

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Horizon Technology Finance Corporation and Subsidiaries

Consolidated Schedule of Investments
September 30, 2011 — (Continued)
(In thousands)

Portfolio Company	Sector	Type of Investment(3)	Interest Rate(4)	Maturity	Cost of Investment(6)	Fair Value
Xtera Communications, Inc.	Semiconductors	Preferred Stock Warrants	—	—	206	242
Vette Corp.	Data Storage	Preferred Stock Warrants(1)	—	—	75	48
XIOtech, Inc.	Data Storage	Preferred Stock Warrants(1)	—	—	22	80
Cartera Commerce, Inc.	Internet and media	Preferred Stock Warrants(1)	—	—	16	30
Grab Networks, Inc.	Networking	Preferred Stock Warrants(1)	—	—	74	—
IntelePeer, Inc.	Networking	Preferred Stock Warrants(1)	—	—	39	524
Motion Computing, Inc.	Networking	Preferred Stock Warrants(1)	—	—	7	334
Impinj, Inc.	Semi-conductor	Preferred Stock Warrants(1)	—	—	7	—
Clarabridge, Inc.	Software	Preferred Stock Warrants(1)	—	—	27	24
Construction Software Technologies, Inc.	Software	Preferred Stock Warrants(2)	—	—	45	44
Courion Corporation	Software	Preferred Stock Warrants(1)	—	—	85	100
DriveCam, Inc.	Software	Preferred Stock Warrants(1)	—	—	20	7
Netuitive, Inc.	Software	Preferred Stock Warrants(1)	—	—	27	21
Recondo Technology, Inc.	Software	Preferred Stock Warrants(1)	—	—	47	47
Seapass Solutions, Inc.	Software	Preferred Stock Warrants(2)	—	—	43	42
StreamBase Systems, Inc.	Software	Preferred Stock Warrants(1)	—	—	67	68
Total Warrants — Technology					1,029	2,051
Warrants — Cleantech — 0.2%						
Cereplast, Inc.(5)	Waste Recycling	Common Stock Warrants(1)	—	—	112	28
Enphase Energy, Inc.	Energy Efficiency	Preferred Stock Warrants(1)	—	—	175	136
Satcon Technology Corporation(5)	Energy Efficiency	Common Stock Warrants(1)	—	—	285	5
Tigo Energy, Inc.	Energy Efficiency	Preferred Stock Warrants(1)	—	—	101	79
Total Warrants — Cleantech					673	248

Warrants — Healthcare information and services — 0.8%						
BioScale, Inc.	Diagnostics	Preferred Stock Warrants(1)	—	—	54	62
Precision Therapeutics, Inc.	Diagnostics	Preferred Stock Warrants	—	—	73	158
Radisphere National Radiology Group, Inc.	Diagnostics	Preferred Stock Warrants(1)	—	—	167	372
Aperio Technologies, Inc.	Other Healthcare	Preferred Stock Warrants	—	—	35	34
Patientkeeper, Inc.	Other Healthcare	Preferred Stock Warrants	—	—	269	266
Singulex, Inc.	Other Healthcare	Preferred Stock Warrants(1)	—	—	40	31
Talyst, Inc.	Other Healthcare	Preferred Stock Warrants(1)	—	—	100	82
Total Warrants — Healthcare information and services					738	1,005
Total Warrants					3,813	5,091
Equity — 0.5%						
Insmed Incorporated(5)	Biotechnology	Common Stock(1)	—	—	227	169
Overture Networks Inc.	Communications	Preferred Stock(1)	—	—	480	524
Total Equity					707	693
Total Investments Assets					$ 179,651	$ 180,186
Investment Liabilities						
Derivative Agreement						
WestLB, AG	Interest rate swap — pay fixed/receive floating, Notional Amount $10 million		3.58 %	10/14/2011		13
Total Investment Liabilities					$ —	$ 13

(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.
(4) All interest is payable in cash due monthly in arrears, unless otherwise indicated and applies only to the Company's debt investments. Amount is the annual interest rate on the debt investment and does not include any additional fees related to the investment, such as deferred interest, commitment fees or prepayment fees. The majority of the debt investments are at fixed rates for the term of the loan. For each debt investment, we have provided the current interest rate in effect as of September 30, 2011.
(5) Portfolio company is a public company.

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

See Notes to Consolidated Financial Statements

Horizon Technology Finance Corporation and Subsidiaries

Consolidated Schedule of Investments
December 31, 2010
(In thousands)

Portfolio Company	Sector	Type of Investment(2)	Interest Rate(3)	Maturity	Cost of Investment(5)	Fair Value
Debt Investments						
Debt Investments — Life Science — 39.3%						
ACT Biotech, Inc.	Biotechnology	Term Loan(1)	12.10 %	6/1/2013	$ 958	$ 958
		Term Loan(1)	12.01 %	6/1/2013	957	957
		Term Loan(1)	12.01 %	6/1/2013	1,478	1,478
Ambit Biosciences, Inc.	Biotechnology	Term Loan(1)	12.25 %	10/1/2013	5,898	5,898
GenturaDx, Inc.	Biotechnology	Term Loan	11.25 %	4/1/2014	1,917	1,917
Novalar Pharmaceuticals, Inc.	Biotechnology	Term Loan(1)	12.00 %	6/1/2012	3,146	3,146
Pharmasset, Inc.(4)	Biotechnology	Term Loan(1)	12.00 %	8/1/2011	868	868
		Term Loan(1)	12.00 %	1/1/2012	1,448	1,448
		Term Loan(1)	12.50 %	10/1/2012	2,422	2,422
Revance Therapeutics, Inc.	Biotechnology	Term Loan(1)	10.50 %	12/1/2011	1,445	1,445
		Term Loan(1)	10.50 %	3/1/2013	3,478	3,478
Tranzyme, Inc.	Biotechnology	Term Loan(1)	10.75 %	1/1/2014	4,966	4,966
Xcovery Holding Company, LLC	Biotechnology	Term Loan	12.00 %	10/1/2013	1,490	1,490
Concentric Medical, Inc.	Medical Device	Term Loan(1)	12.04 %	9/1/2013	6,887	6,887
OraMetrix, Inc.	Medical Device	Term Loan(1)	11.50 %	4/1/2014	4,887	4,887
PixelOptics, Inc.	Medical Device	Term Loan(1)	13.00 %	1/1/2013	4,221	4,221
Tengion, Inc.(4)	Medical Device	Term Loan(1)	12.26 %	9/1/2011	2,740	2,740
ViOptix, Inc.	Medical Device	Term Loan(1)	13.55 %	11/1/2011	885	837
Total Debt Investments — Life Science					50,091	50,043
Debt Investments — Technology — 24.4%						
Hatteras Networks, Inc.	Communications	Term Loan(1)	12.40 %	2/1/2011	1,042	1,042
OpenPeak, Inc.	Communications	Term Loan(1)	11.86 %	12/1/2013	6,549	6,549
Starcite, Inc.	Consumer-related technologies	Term Loan(1)	12.05 %	9/1/2012	2,679	2,679
Tagged, Inc.	Consumer-related technologies	Term Loan(1)	12.78 %	5/1/2012	1,284	1,284

		Term Loan(1)	11.46	%	8/1/2012	498	498
Vette Corp.	Data Storage	Term Loan(1)	11.75	%	7/1/2014	4,916	4,916
XIOtech, Inc.	Data Storage	Term Loan(1)	14.00	%	5/1/2012	2,997	2,997
IntelePeer, Inc.	Networking	Term Loan(1)	12.43	%	4/1/2012	515	515
		Term Loan(1)	12.33	%	6/1/2012	598	598
		Term Loan(1)	12.33	%	10/1/2012	1,171	1,171
Clarabridge, Inc.	Software	Term Loan(1)	12.50	%	1/1/2013	1,166	1,166
		Term Loan(1)	12.50	%	6/1/2013	688	688
		Term Loan(1)	12.50	%	5/1/2014	743	743
Courion Corporation	Software	Term Loan(1)	11.45	%	12/1/2011	1,083	1,083
Netuitive, Inc.	Software	Term Loan(1)	12.90	%	4/1/2011	152	152
StreamBase Systems, Inc.	Software	Term Loan(1)	12.51	%	11/1/2013	3,934	3,934
		Term Loan(1)	12.50	%	6/1/2014	977	977
Total Debt Investments — Technology						30,992	30,992
Debt Investments — Cleantech — 14.9%							
Cereplast, Inc.(4)	Waste Recycling	Term Loan(1)	12.00	%	4/1/2014	2,363	2,363
Enphase Energy, Inc.	Energy Efficiency	Term Loan(1)	12.60	%	10/1/2013	6,869	6,869
Satcon Technology Corporation(4)	Energy Efficiency	Term Loan(1)	12.58	%	1/1/2014	9,701	9,701
Total Debt Investments — Cleantech						18,933	18,933

See Notes to Consolidated Financial Statements

Horizon Technology Finance Corporation and Subsidiaries

Consolidated Schedule of Investments
December 31, 2010 — (Continued)
(In thousands)

Portfolio Company	Sector	Type of Investment(2)	Interest Rate(3)	Maturity	Cost of Investment(5)	Fair Value
Debt Investments — Healthcare information and services — 23.8%						
BioScale, Inc.	Diagnostics	Term Loan(1)	12.00%	8/1/2012	2,454	2,454
		Term Loan(1)	11.51%	1/1/2014	4,908	4,908
Precision Therapeutics, Inc.	Diagnostics	Term Loan(1)	13.00%	3/1/2012	3,255	3,255
Radisphere National Radiology Group, Inc.	Diagnostics	Term Loan(1)	12.75%	1/1/2014	9,855	9,855
Singulex, Inc.	Other Healthcare	Term Loan(1)	11.00%	3/1/2014	2,949	2,949
		Term Loan(1)	11.00%	3/1/2014	1,964	1,964
Talyst, Inc.	Other Healthcare	Term Loan(1)	12.10%	12/1/2013	2,443	2,443
		Term Loan(1)	12.05%	12/1/2013	2,438	2,438
Total Debt Investment — Healthcare information and services					30,266	30,266
Total Debt Investments					130,282	130,234
Warrant Investments						
Warrants — Life Science — 2.1%						
ACT Biotech, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	23	23
Ambit Biosciences, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	143	147
Anesiva, Inc.(4)	Biotechnology	Common Stock Warrants(1)	—	—	18	—
GenturaDx, Inc.	Biotechnology	Preferred Stock Warrants	—	—	63	63
Novalar Pharmaceuticals, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	69	—
Pharmasset, Inc.(4)	Biotechnology	Common Stock Warrants(1)	—	—	126	789
Revance Therapeutics, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	224	121
Tranzyme, Inc.	Biotechnology	Preferred Stock Warrants(1)	—	—	1	1
Advanced BioHealing, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	9	1,209
Calypso Medical Technologies, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	17	76
Concentric Medical, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	85	89
EnteroMedics, Inc.(4)	Medical Device	Common Stock Warrants(1)	—	—	347	18

OraMetrix, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	78	83
PixelOptics, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	61	61
Tengion, Inc.(4)	Medical Device	Common Stock Warrants(1)	—	—	15	—
ViOptix, Inc.	Medical Device	Preferred Stock Warrants(1)	—	—	13	—
Total Warrants — Life Science					1,292	2,680
Warrants — Technology — 1.2%						
Hatteras Networks, Inc.	Communications	Preferred Stock Warrants(1)	—	—	—	35
OpenPeak, Inc.	Communications	Preferred Stock Warrants(1)	—	—	89	92
Everyday Health, Inc.	Consumer related technologies	Preferred Stock Warrants(1)	—	—	69	137
SnagAJob.com, Inc.	Consumer-related technologies	Preferred Stock Warrants(1)	—	—	23	39
Starcite, Inc.	Consumer-related technologies	Preferred Stock Warrants(1)	—	—	24	28
Tagged, Inc.	Consumer-related technologies	Preferred Stock Warrants(1)	—	—	17	27
Vette Corp.	Data Storage	Preferred Stock Warrants(1)	—	—	75	49
XIOtech, Inc.	Data Storage	Preferred Stock Warrants(1)	—	—	22	81
Cartera Commerce, Inc.	Internet and media	Preferred Stock Warrants(1)	—	—	16	38
Grab Networks, Inc.	Networking	Preferred Stock Warrants(1)	—	—	74	—
IntelePeer, Inc.	Networking	Preferred Stock Warrants(1)	—	—	39	544
Motion Computing, Inc.	Networking	Preferred Stock Warrants(1)	—	—	7	292
Impinj, Inc.	Semi-conductor	Preferred Stock Warrants(1)	—	—	7	—

See Notes to Consolidated Financial Statements

Horizon Technology Finance Corporation and Subsidiaries

Consolidated Schedule of Investments
December 31, 2010 — (Continued)
(In thousands)

Portfolio Company	Sector	Type of Investment(2)	Interest Rate(3)	Maturity	Cost of Investment(5)	Fair Value
Clarabridge, Inc.	Software	Preferred Stock Warrants(1)	—	—	28	25
Courion Corporation	Software	Preferred Stock Warrants(1)	—	—	7	17
DriveCam, Inc.	Software	Preferred Stock Warrants(1)	—	—	20	8
Netuitive, Inc.	Software	Preferred Stock Warrants(1)	—	—	27	22
Plateau Systems, Ltd.	Software	Preferred Stock Warrants(1)	—	—	7	35
StreamBase Systems, Inc.	Software	Preferred Stock Warrants(1)	—	—	67	69
Total Warrants — Technology					618	1,538
Warrants — Cleantech — 1.0%						
Cereplast, Inc.(4)	Waste Recycling	Common Stock Warrants(1)	—	—	112	112
Enphase Energy, Inc.	Energy Efficiency	Preferred Stock Warrants(1)	—	—	122	122
Satcon Technology Corporation(4)	Energy Efficiency	Common Stock Warrants(1)	—	—	286	1,057
Total Warrants — Cleantech					520	1,291
Warrants — Healthcare information and services — 0.6%						
BioScale, Inc.	Diagnostics	Preferred Stock Warrants(1)	—	—	55	49
Precision Therapeutics, Inc.	Diagnostics	Preferred Stock Warrants(1)	—	—	52	139
Radisphere National Radiology Group, Inc.	Diagnostics	Preferred Stock Warrants(1)	—	—	167	384
Singulex, Inc.	Other Healthcare	Preferred Stock Warrants(1)	—	—	39	39
Talyst, Inc.	Other Healthcare	Preferred Stock Warrants(1)	—	—	100	105
Total Warrants — Healthcare information and services					413	716
Total Warrants					2,843	6,225
Equity — 0.3%						

AFS Technologies, Inc	Common Stock(1)	—	—	142	142
Insmed Incorporated(4)	Common Stock and Convertible Preferred Stock(1)	—	—	227	209
Total Equity				369	351
Total Investments Assets				$ 133,494	$ 136,810
Investment Liabilities					
Derivative Agreement					
WestLB, AG	Interest rate swap — pay fixed/receive floating, Notional Amount $10 million	3.518/14/2011		—	258
Total Investment Liabilities				$ —	$ 258

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(1) Has been pledged as collateral under the WestLB Facility.
(2) All investments are less than 5% ownership of the class and ownership of the portfolio company.
(3) All interest is payable in cash due monthly in arrears, unless otherwise indicated and applies only to the Company's debt investments. Amount is the annual interest rate on the debt investment and does not include any additional fees related to the investment, such as deferred interest, commitment fees or prepayment fees. The majority of the debt investments are at fixed rates for the term of the loan. For each debt investment, we have provided the current interest rate in effect as of December 31, 2010.
(4) Portfolio company is a public company.
(5) For debt investments, represents principal balance less unearned income.

See Notes to Consolidated Financial Statements

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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 will not be 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 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. CHF sold certain portfolio transactions to Credit I (“Purchased Assets”). Credit I is a separate legal entity from CHF and the Purchased 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 will not be available to creditors of the Company or any other entity other than Credit II’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 receiving a license to operate a small business investment company (“SBIC”) from the U. S. Small Business Administration (“SBA”). There has been no activity in Horizon SBIC since its 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

Election to become a Business Development Company and Basis of Financial Statement Presentation

The results of operations for the three and nine months ended September 30, 2011 reflect the Company’s results as a BDC under the 1940 Act, whereas the operating results for the three and nine months ended September 30, 2010 reflect the Company’s results prior to operating as a BDC under the 1940 Act. Accounting principles used in the preparation of these two periods are different and, therefore, the financial position and results of operations of these periods are not directly comparable. The primary differences in accounting principles relate to the carrying value of debt investments and classification of hedging activity — see corresponding sections below for further discussion.

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.

Horizon Technology Finance Corporation and Subsidiaries

Notes to Consolidated Financial Statements
(In thousands, except shares and per share data)

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.

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 loans, equity investments and warrants.

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 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 amendments are to be applied prospectively and are effective for interim and annual periods beginning after December 15, 2011. Management is currently evaluating the effect that the provisions of ASU 2011-04 will have on the Company's financial statements.

See Note 5 for additional information regarding fair value.

Horizon Technology Finance Corporation and Subsidiaries

Notes to Consolidated Financial Statements
(In thousands, except shares and per share data)

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.

Cash and Cash Equivalents

Cash and cash equivalents as presented in the consolidated balance sheets and the consolidated statements of cash flows include bank checking accounts and money market funds with an original maturity of less than 90 days.

Investments

Investments are recorded at fair value. The Company's board of directors ("Board") determines the fair value of its portfolio investments. Prior to the Company's election to become a BDC, debt investments were stated at current unpaid principal balances adjusted for the allowance for loan losses, unearned income and any unamortized deferred fees or costs.

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. No loans were on non-accrual status as of September 30, 2011 and December 31, 2010.

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.

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 gain on investments.

See Note 5 for additional information regarding fair value.

Horizon Technology Finance Corporation and Subsidiaries

Notes to Consolidated Financial Statements
(In thousands, except shares and per share data)

Allowance for Loan Losses

Prior to the Company's election to become a BDC, the allowance for loan losses represented management's estimate of probable loan losses inherent in the loan portfolio as of the balance sheet date. The estimation of the allowance was based on a variety of factors, including past loan loss experience, the current credit profile of the Company's borrowers, adverse situations that had occurred that may affect individual borrowers' ability to repay, the estimated value of underlying collateral and general economic conditions. The loan portfolio is comprised of large balance loans that are evaluated individually for impairment and are risk-rated based upon a borrower's individual situation, current economic conditions, collateral and industry-specific information that management believes is relevant in determining the potential occurrence of a loss event and in measuring impairment. The allowance for loan losses was sensitive to the risk rating assigned to each of the loans and to corresponding qualitative loss factors that the Company used to estimate the allowance. Those factors were applied to the outstanding loan balances in estimating the allowance for loan losses. If necessary, based on performance factors related to specific loans, specific allowances for loan losses were established for individual impaired loans. Increases or decreases to the allowance for loan losses were charged or credited to current period earnings through the provision (credit) for loan losses. Amounts determined to be uncollectible were charged against the allowance for loan losses, while amounts recovered on previously charged-off loans increased the allowance for loan losses.

A loan was considered impaired when, based on current information and events, it was probable that the Company was unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment included payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experienced insignificant payment delays and payment shortfalls generally were not classified as impaired. Management determined the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment was measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral, if the loan was collateral dependent.

Impaired loans also included loans modified in troubled debt restructurings where concessions had been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

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 are recognized as assets and are amortized as interest expense over the term of the related credit facility. The unamortized balance of debt issuance costs as of September 30, 2011 and December 31, 2010, included in other assets, was $1,174 and $194, respectively. The accumulated amortization balances as of September 30, 2011 and December 31, 2010 was $227 and $3,292, respectively. The amortization expense for the nine months ended September 30, 2011 and 2010 relating to debt issuance costs was $227 and $871, 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 nine months ended September 30, 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, 2011 and December 31, 2010. The 2008 and 2009 tax years remain subject to examination by U.S. federal and state tax authorities.

Horizon Technology Finance Corporation and Subsidiaries

Notes to Consolidated Financial Statements
(In thousands, except shares and per share data)

Prior to the Company's election to become a BDC, the Company was a limited liability company treated as a partnership for U.S. federal income tax purposes and, as a result, all items of income and expense were passed through to, and are generally reportable on, the tax returns of the respective members of the limited liability company. Therefore, no federal or state income tax provision has been recorded for the nine months ended September 30, 2010.

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 ("DRIP") 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.

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.

Subsequent to the Company's election to become a BDC, 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.

Prior to the Company's election to become a BDC, the Company recognized its interest rate swap derivatives on the balance sheet as either an asset or liability measured at fair value. Changes in the derivatives' fair value were recognized in income unless specific hedge accounting criteria were met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the statement of operations and required the Company to formally document, designate and assess effectiveness of transactions that receive hedge accounting. Derivatives that are not hedges are adjusted to fair value through earnings. If the derivative qualifies as a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of hedged assets, liabilities or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value, if any, would have been recognized as interest expense.

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.

Horizon Technology Finance Corporation and Subsidiaries

Notes to Consolidated Financial Statements
(In thousands, except shares and per share data)

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 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 base management fee expense was $1,091 and $3,229 for the three and nine months ended September 30, 2011, respectively. The accrued management fee as of September 30, 2011 and December 31, 2010 was $362 and $360, 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 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.

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.

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The total performance based incentive fee expense was $561 and $2,701 for the three and nine months ended September 30, 2011, respectively. The incentive fee payable as of September 30, 2011 and December 31, 2010 was $1,453 and $414, respectively. The incentive fee payable as of September 30, 2011 includes $711 for part one and $742 for part two of the incentive fee, respectively.

Prior to the Company's election to become a BDC, the Advisor served as the Advisor for CHF under a Management and Services Agreement which provided for management fees to be paid monthly at a rate of 2.00% per annum of the gross investment assets of CHF. Total management fee expense under this agreement was $675 and $1,816 for the three and nine months ended September 30, 2010, respectively.

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 the three and nine months ended September 30, 2011, $355 and $873, respectively, was charged to operations under this Administration Agreement.

From time to time, the Advisor may pay amounts owed by the Company to third-party providers of goods or services. The Company will subsequently reimburse the Advisor for such amounts paid on the Company's behalf.

Note 4. Investments

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

	September 30, 2011		December 31, 2010	
	Cost	Fair Value	Cost	Fair Value
Debt	$175,131	$174,402	$130,282	$130,234
Warrants	3,813	5,091	2,843	6,225
Equity	707	693	369	351
Total	$179,651	$180,186	$133,494	$136,810

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

	September 30, 2011		December 31, 2010	
	Cost	Fair Value	Cost	Fair Value
Life Science				
Biotechnology	$29,038	$29,084	$31,138	$31,614
Medical Device	27,539	27,489	20,472	21,317
Technology				
Consumer-related Technologies	2,705	3,014	4,592	4,692

Networking	1,402	2,140	2,405	3,120
Software	24,080	24,073	9,042	9,062
Data Storage	5,042	5,086	8,010	8,042
Internet and Media	—	—	16	38
Communications	6,588	6,173	7,681	7,719
Semiconductors	9,952	9,980	7	—
Healthcare Information and Services				
Diagnostics	22,879	23,177	20,745	21,044
Other Healthcare Related Services and Technologies	19,385	19,354	9,934	9,938
Cleantech				
Energy Efficiency	26,039	25,699	16,977	17,749
Waste Recycling	5,002	4,917	2, 475	2,475
Total	$179,651	$180,186	$133,494	$136,810

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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.

Cash and cash equivalents 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.

Loans: For variable rate loans that re-price frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolio. The fair value of fixed rate loans is estimated by discounting the future cash flows using the year end rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolio. Therefore, the Company has categorized loan investments as Level 3 within the fair value hierarchy described above. These financial instruments are recorded at fair value on a recurring basis.

Warrants: The Company primarily 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.

- 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, 2011 and December 31, 2010 was 30%.

- 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.

- 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 valuation at September 30, 2011 and December 31, 2010 was 20%.

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. Prior to September 30, 2011, there were no warrants that required valuation under an alternate technique.

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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 in Note 2. 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 financial instruments are recorded at fair value on a recurring basis.

Equities: 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. 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.

Borrowings: The carrying amount of borrowings under the revolving credit facilities approximates its fair value due to the variable interest rate of these borrowings. Additionally, the Company considers its creditworthiness in determining the fair value of such borrowings. These financial instruments are not recorded at fair value on a recurring basis.

Interest rate swap derivatives: The fair value of the Company's interest rate swap derivative instruments is estimated as the amount the Company would pay to terminate its swaps at the balance sheet date, taking into account current interest rates and the creditworthiness of the counterparty for assets and the creditworthiness of the Company for liabilities. The Company has categorized these derivative instruments as Level 2 within the fair value hierarchy described above. These financial instruments are 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. Off-balance-sheet instruments are not recorded at fair value on a recurring basis.

The following tables detail the financial instruments that are carried at fair value and measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	September 30, 2011			
	Total	Level 1	Level 2	Level 3
Loan investments	$174,402	$—	$—	$174,402
Warrant investments	$5,091	$—	$56	$5,035
Equity investments	$693	$169	$—	$524
Interest rate swap liability	$13	$—	$13	$—

	December 31, 2010			
	Total	Level 1	Level 2	Level 3
Loan investments	$130,234	$—	$—	$130,234

Warrant investments	$6,225	$—	$1,976	$4,249
Equity investments	$351	$209	$—	$142
Interest rate swap liability	$258	$—	$258	$—

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The following tables show a reconciliation of the beginning and ending balances for Level 3 assets for the three months ended September 30, 2011 and 2010:

	Three months ended September 30, 2011			
	Loan 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 and equity received and classified as Level 3	—	47	—	47
Principal payments received on investments	(12,874)	—	—	(12,874)
Unrealized (depreciation) appreciation included in earnings	(282)	703	—	421
Other	448	(75)	(144)	229
Level 3 assets, end of period	$ 174,402	$ 5,035	$ 524	$ 179,961

	Three months ended September 30, 2010			
	Loan Investments	Warrant Investments	Equity Investments	Total
Level 3 assets, beginning of period	$ —	$ 2,343	$ —	$ 2,343
Purchase of investments	—	—	—	—
Warrants and equity received and classified as Level 3	—	104	—	104
Principal payments received on investments	—	—	—	—
Unrealized appreciation included in earnings	—	1,268	—	1,268
Other	—	—	—	—
Level 3 assets, end of period	$ —	$ 3,715	$ —	$ 3,715

The following tables show a reconciliation of the beginning and ending balances for Level 3 assets for the nine months ended September 30, 2011 and 2010:

	Nine months ended September 30, 2011			
	Loan 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)
Unrealized (depreciation) appreciation included in earnings	(681)	(163)	44	(800)
Other	(733)	(91)	(144)	(968)
Level 3 assets, end of period	$ 174,402	$ 5,035	$ 524	$ 179,961

	Nine months ended September 30, 2010			
	Loan Investments	Warrant Investments	Equity Investments	Total
Level 3 assets, beginning of period	$ —	$ 2,010	$ —	$ 2,010
Purchase of investments	—	—	—	—
Warrants and equity received and classified as Level 3	—	927	—	927
Principal payments received on investments	—	—	—	—
Unrealized appreciation included in earnings	—	780	—	780
Other	—	(2)	—	(2)
Level 3 assets, end of period	$ —	$ 3,715	$ —	$ 3,715

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The total change in unrealized appreciation and depreciation included in the consolidated statement of operations attributable to Level 3 investments still held at September 30, 2011 includes $681 depreciation on loans, $2,142 appreciation on warrants and $44 appreciation on equity investments.

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 at year-end.

As of September 30, 2011 and December 31, 2010, the recorded book balances and fair values of the Company's financial instruments were as follows:

	September 30, 2011		December 31, 2010	
	Recorded Book Balance	Fair Value	Recorded Book Balance	Fair Value
Financial assets:				
Cash & cash equivalents	$ 32,598	$ 32,598	$ 76,793	$ 76,793
Investments:				
Debt	$ 174,402	$ 174,402	$ 130,234	$ 130,234
Warrants	$ 5,091	$ 5,091	$ 6,225	$ 6,225
Equity	$ 693	$ 693	$ 351	$ 351
Interest receivable	$ 2,477	$ 2,477	$ 1,938	$ 1,938
Financial liabilities:				
Borrowings	$ 81,885	$ 81,885	$ 87,425	$ 87,425
Interest rate swap liability	$ 13	$ 13	$ 258	$ 258

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, 2011, the asset coverage for borrowed amounts was 257%.

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 (0.24% as of September 30, 2011 and 0.26% as of December 31, 2010) plus a spread of 2.50%. The rates at September 30, 2011 and December 31, 2010 were 2.74% and 2.76%, respectively, and the average rates for the nine months ended September 30, 2011 and 2010 were 2.78%, and 2.79%, respectively.

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 $78,100 and $78,200 for the nine months ended September 30, 2011 and 2010, respectively. At September 30, 2011 and December 31, 2010, the Company had borrowings outstanding of $66,049 and $87,425, respectively, on the WestLB Facility.

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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 September 30, 2011 was 5.0%, and the average rate for the three months ended September 30, 2011 was 5.0%.

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 was approximately $15,100 for the three months ended September 30, 2011. At September 30, 2011, the Company had borrowings outstanding of $15,836 on the Wells 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 balance sheet. The Company attempts to limit its credit risk by conducting extensive due diligence and obtaining collateral where appropriate.

The balance of unfunded commitments to extend credit was approximately $18,667 and $26,500 as of September 30, 2011 and December 31, 2010, respectively. Commitments to extend credit consist principally of the unused portions of commitments that obligate the Company to extend credit. 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 aggregate outstanding principal balance of the Company's five largest loans represented approximately 27% and 31% of the aggregate outstanding principal balance of all loans outstanding as of September 30, 2011 and December 31, 2010, respectively. No single loan represents more than 10% of the total loans as of September 30, 2011 and December 31, 2010. 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 25% and 19% of total loan interest and fee income for the nine months ended September 30, 2011 and 2010, 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 will expire 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 from the Swap was recorded in the statement of operations, and approximately $255 of net realized losses from the Swap was recorded in the consolidated statement of operations.

Prior to the Company’s election to become a BDC, the Swap was designated as a hedging instrument and the Company applied cash flow hedge accounting. The Swap was recorded in the consolidated statement of assets and liabilities at fair value, and any related increases or decreases in the fair value were recognized within accumulated other comprehensive income.

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Prior to the Company's election to become a BDC, the Company assessed the effectiveness of the Swap on a quarterly basis. The Company had considered the impact of the then current credit crisis in the United States in assessing the risk of counterparty default. As most of the critical terms of the hedging instruments and hedged items matched, the hedging relationship was considered to be highly effective. No ineffectiveness on the Swap was recognized during the nine months ended September 30, 2010.

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 during the nine months ended September 30, 2011.

Date Declared	Record Date	Payment Date	Amount Per Share	Cash Distribution	DRIP Shares Issued	DRIP Share Value
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

On November 8, 2011, the Company declared a third quarter dividend of $0.45 per share, payable on November 30, 2011 to stockholders of record on November 18, 2011.

Note 11: Financial Highlights

The financial highlights for the Company are as follows: (1)

	Three months ended September 30, 2011		Nine months ended September 30, 2011	
Per share data:				
Net asset value at beginning of period	$ 17.40		$ 16.75	
Dividends declared and paid	(0.40	)	(0.73	)
Net investment income	0.39		0.95	
Realized gain on investments	0.00		0.73	
Net change in unrealized depreciation on investments	(0.03	)	(0.34	)
Net asset value at end of period	$ 17.36		$ 17.36	
Per share market value, end of period	$ 14.66		$ 14.66	
Total return based on average net asset value	8.3	%	10.5	%
Shares outstanding at end of period	7,626,718		7,626,718	
Ratios to average net assets:				
Expenses without incentive fees	8.7	%(2)	8.2	%(2)
Incentive fees	1.7	%(2)	2.8	%(2)
Total expenses	10.4	%(2)	11.1	%(2)
Net investment income without incentive fees	10.7	%(2)	10.2	%(2)
Average net asset value	$ 132,417		$ 129,786	

(1) Periods prior to becoming a public company are not presented in the financial highlights because the Company did not record assets at fair value, therefore the information would not be meaningful.
(2) 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. For periods prior to October 28, 2010, the consolidated financial statements and related footnotes reflect the performance of our predecessor, Compass Horizon Funding Company LLC, and its wholly owned subsidiary, Horizon Credit I LLC, both of which were formed in January 2008 and commenced operations in March 2008. 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 "Technology Loans," to companies backed by established venture capital and private equity firms in our Target Industries, which we refer to as "Technology 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.

Compass Horizon Funding Company LLC, which we refer to as "Compass Horizon," our predecessor company, commenced operation 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 by asset class as of September 30, 2011 and December 31, 2010.

	September 30, 2011			December 31, 2010		
	# of Investments	Fair Value	% of Total Portfolio	# of Investments	Fair Value	% of Total Portfolio
	($ in thousands)					
Term loans	35	$ 170,187	94.5 %	31	$ 127,949	93.5 %
Revolving loans	1	2,933	1.6 %	—	—	—
Equipment loans	1	1,282	0.7 %	1	2,285	1.6 %
Total loans	37	174,402	96.8 %	32	130,234	95.1 %
Warrants	48	5,091	2.8 %	43	6,225	4.6 %
Equity	2	693	0.4 %	2	351	0.3 %
Total		$ 180,186	100.0 %		$ 136,810	100.0 %

Total portfolio investment activity for the periods ended September 30, 2011 and 2010 was as follows:

	For the three months ended September 30, 2011	For the three months ended September 30, 2010	For the nine months ended September 30, 2011	For the nine months ended September 30, 2010
	($ in thousands)			
Beginning portfolio	$186,029	$ 143,008	$136,810	$ 113,878
New loan funding	7,000	15,000	86,833	75,517
Less refinanced balances	—	—	(8,677)	(10,909)
Net new loan funding	7,000	15,000	78,156	64,608
Principal and stock payments received on investments	(8,559)	(11,278)	(22,666)	(28,104)
Early pay-offs	(4,315)	(9,777)	(9,908)	(13,231)
Accretion of loan fees	527	451	1,356	934
New loan fees	(40)	(134)	(967)	(651)
New equity investments	—	79	577	79
Net depreciation on investments	(456)	1,654	(3,172)	1,490
Ending portfolio	$180,186	$ 139,003	$180,186	$ 139,003

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, 2011 and December 31, 2010:

	September 30, 2011 Loans at Fair Value	September 30, 2011 Percentage of Total Portfolio	December 31, 2010 Loans at Fair Value	December 31, 2010 Percentage of Total Portfolio
	($ in thousands)			
Life Science				
Biotechnology	$ 28,118	16.1%	$ 30,470	23.4%
Medical Device	26,499	15.2%	19,572	15.0%
Technology				
Consumer-related Technologies	2,574	1.5%	4,460	3.4%
Networking	1,282	0.7%	2,285	1.8%
Semiconductors	9,739	5.6%	—	0.0%
Software	23,719	13.6%	8,745	6.7%
Data Storage	4,929	2.8%	7,912	6.1%
Communications	5,648	3.2%	7,591	5.9%
Cleantech				
Energy Efficiency	25,479	14.6%	16,570	12.7%
Waste Recycling	4,889	2.8%	2,363	1.8%
Healthcare Information and Services				
Diagnostics	22,584	13.0%	20,472	15.7%
Other Healthcare Related Services and Technologies	18,942	10.9%	9,794	7.5%

Total	$ 174,402	100.0%	$ 130,234	100.0%

The largest loans may vary from year to year as new loans are recorded and repaid. Our five largest loans represented approximately 27% and 31% of total loans outstanding as of September 30, 2011 and December 31, 2010, respectively. No single loan represented more than 10% of our total loans as of September 30, 2011 and December 31, 2010.

As of September 30, 2011 and December 31, 2010, interest receivable was $2.5 million and $1.9 million, respectively, which represents one month of accrued interest income on loans. The increase in 2011 was due to a larger loan portfolio relative to 2010.

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, 2011 and December 31, 2010:

	September 30, 2011		December 31, 2010	
	Loans at Fair Value	Percentage of Loan Portfolio	Loans at Fair Value	Percentage of Loan Portfolio
Credit Rating	($ in thousands)			
4	$ 34,161	19.6 %	$ 29,054	22.3 %
3	126,168	72.3 %	$ 94,200	72.3 %
2	14,073	8.1 %	$ 6,980	5.4 %
1	—	—	—	—
Total	$ 174,402	100.0 %	$ 130,234	100.0 %

As of September 30, 2011 and December 31, 2010, our loan portfolio had a weighted average credit rating of 3.2. As of September 30, 2011 and December 31, 2010, no investments were on non-accrual status.

Consolidated Results of Operations for the three months ended September 30, 2011 and 2010

The consolidated results of operations set forth below include historical financial information of our predecessor, Compass Horizon, prior to our election to become a BDC and our election to be treated as a RIC. As a BDC and a RIC for U.S. federal income tax purposes, we are also subject to certain constraints on our operations, including limitations imposed by the 1940 Act and the Code. Also, the management fee that we pay to our Advisor under the Investment Management Agreement is determined by reference to a formula that differs materially from the management fee paid by Compass Horizon in prior periods. For these and other reasons set forth below, the results of operations described below may not be indicative of the results we report in future periods.

Consolidated operating results for the three months ended September 30, 2011 and 2010 are as follows:

	For the three months ended September 30,	
	2011	2010
	($ in thousands)	
Total investment income	$ 6,441	$ 5,189
Total expenses	3,448	1,932
Net investment income	2,993	3,257
Net realized loss on investments	(17)	—
Net unrealized (depreciation) appreciation on investments	(217)	1,711
Credit for loan losses	—	320
Net increase in net assets resulting from operations	$ 2,759	$ 5,288
Average debt investments, at fair value	$ 180,951	$ 137,867

Average borrowings outstanding	$ 80,871	$ 91,640

Net investment income for the three months ended September 30, 2011 was $3.0 million or $0.39 per share. Excluding the impact of the reduction in the second part of the incentive fee expense of $0.2 million, net investment income totaled $2.8 million or $0.37 per share.

Investment Income

Investment income increased by $1.3 million, or 24.1%, for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. For the three months ended September 30, 2011, total investment income consisted primarily of $6.1 million in interest income from investments, which included $0.5 million in income from the amortization of discounts and origination fees on investments. Interest income on investments and other investment income increased primarily due to the increased average size of the loan portfolio. Fee income on investments was primarily comprised of prepayment fees collected from our portfolio companies. For the three months ended September 30, 2010, total investment income consisted primarily of $5.0 million in interest income from investments, which included $0.5 million in income from the amortization of discounts and origination fees on investments. For the three months ended September 30, 2011 and 2010, our dollar-weighted average annualized yield on average loans was approximately 14.2% and 15.0%, 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 27% and 31% of investment income for the three months ended September 30, 2011 and 2010, respectively.

Expenses

Total expenses increased by $1.5 million, or 78.5%, to $3.4 million for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. Total operating expenses for each period consisted principally of management fees, incentive and administrative fees and interest expense and, to a lesser degree, professional fees and general and administrative expenses. Interest expense, which includes the amortization of debt issuance costs, decreased for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to the end of our WestLB Facility’s revolving term and the scheduled amortization of the remaining balance.

Effective with the completion of our initial public offering in October 2010, we pay management and incentive fees under the Investment Management Agreement, which provides a higher management fee base as compared to amounts previously paid by Compass Horizon. Base management fee expense for the three months ended September 30, 2011 increased by approximately $0.4 million compared to the three months ended September 30, 2010 primarily due to the higher management fee base. Incentive fees for the three months ended September 30, 2011 totaled approximately $0.6 million compared to no incentive fees for the three months ended September 30, 2010. The incentive fees for the three months ended September 30, 2011 consisted of approximately $0.7 million for part one of the incentive fee offset by a reduction of previously accrued part two incentive fee. In connection with the Administration Agreement, we incurred $0.4 million of administrative expenses for the three months ended September 30, 2011. We did not pay an administrative servicing fee for the three months ended September 30, 2010.

Professional fees and general and administrative expenses include legal and audit fees, insurance premiums, and miscellaneous other expenses. These expenses for the three months ended September 30, 2011 increased by approximately $0.6 million compared to the three months ended September 30, 2010 primarily due to the increased cost of being a public company and the expensing of $0.2 million of previously capitalized costs related to our efforts to obtain a license to operate an SBIC.

Net Realized Gain (Loss) and Net Unrealized Appreciation (Depreciation)

Realized gains or losses 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 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.

Consolidated operating results for the nine months ended September 30, 2011 and 2010

	For the nine months ended September 30,	
	2011	2010
	($ in thousands)	
Total investment income	$ 17,871	$ 13,250
Total expenses	10,670	5,372
Net investment income	7,201	7,878
Net realized gain (loss) on investments	5,544	(2)
Net unrealized (depreciation) appreciation on investments	(2,535)	1,549
Credit for loan losses	—	739
Net increase in net assets resulting from operations	$ 10,210	$ 10,164
Average debt investments, at fair value	$ 162,623	$ 123,298
Average borrowings outstanding	$ 82,606	$ 78,195

Net investment income for the nine months ended September 30, 2011 was $7.2 million or $0.95 per share. Excluding the impact of the capital gains incentive fee expense of $0.7 million, net investment income totaled $7.9 million or $1.04 per share.

Investment Income

Investment income increased by $4.6 million, or 34.9%, for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. For the nine months ended September 30, 2011, total investment income consisted primarily of $16.9 million in interest income from investments, which included $1.3 million in income from the amortization of discounts and origination fees on investments. Interest income on investments and other investment income increased primarily due to the increased average size of the loan portfolio. Fee income on investments was primarily comprised of a one-time success fee received upon the completion of an acquisition of one of our portfolio companies and from prepayment fees collected from our portfolio companies. For the nine months ended September 30, 2010, total investment income consisted primarily of $12.9 million in interest income from investments, which included $0.9 million in income from the amortization of discounts and origination fees on investments. For the nine months ended September 30, 2011 and 2010, our dollar-weighted average annualized yield on average loans was approximately 14.6% and 14.3%, 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 25% and 19% of investment income for the nine months ended September 30, 2011 and 2010, respectively.

Expenses

Total expenses increased by $5.3 million, or 98.6%, to $10.6 million for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. Total operating expenses for each period consisted principally of management fees, incentive and administrative fees, interest expense and, to a lesser degree, professional fees and general and administrative expenses. Interest expense, which includes the amortization of debt issuance costs, decreased for the nine months ended September 30, 2011 compared to the nine months ended

September 30, 2010 primarily due to the expiration of our WestLB Facility's revolving term and the amortization of the remaining balance.

Effective with the completion of our initial public offering in October 2010, we pay management and incentive fees under the Investment Management Agreement, which provides a higher management fee base as compared to amounts previously paid by Compass Horizon. Base management fee expense for the nine months ended September 30, 2011 increased by approximately $1.4 million compared to the nine months ended September 30, 2010 primarily due to the higher management fee base. Incentive fees for the nine months ended September 30, 2011 totaled approximately $2.7 million compared to no incentive fees for the nine months ended September 30, 2010. The incentive fees for the nine months ended September 30, 2011 consisted of approximately $2.0 million and $0.7 million for part one and part two of the incentive fee, respectively. In connection with the Administration Agreement, we incurred $0.9 million of administrative expenses for the nine months ended September 30, 2011. We did not pay an administrative servicing fee for the nine months ended September 30, 2010.

Professional fees and general and administrative expenses include legal and audit fees, insurance premiums and miscellaneous other expenses. These expenses for the nine months ended September 30, 2011 increased by approximately $1.5 million compared to the nine months ended September 30, 2010 primarily due to the increased cost of being a public company and the expensing of previously capitalized costs related to our efforts to obtain a license to operate an SBIC.

Net Realized Gain (Loss) and Net Unrealized Appreciation (Depreciation)

Realized gains or losses 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. Net change in unrealized appreciation or depreciation 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, 2011, we had $5.5 million in net realized gain on investments. Net realized gain on investments resulted primarily from the sale of stock through the exercise of warrants in portfolio companies.

Credit for Loan Losses

For the three and nine months ended September 30, 2010, the credit for loan losses was $320 and $739 respectively. The loan portfolio had a weighted average credit rating of 3.1 as of September 30, 2010. See the section entitled “Loan Portfolio Asset Quality.” As of October 28, 2010 the date of our election to be treated as a BDC, we no longer record a credit or provision for loan losses. We record each individual loan and investment on a quarterly basis at fair value. Changes in fair value are recorded through our statement of operations.

Liquidity and Capital Resources

As of September 30, 2011 and December 31, 2010, we had cash and cash equivalents of $32.6 million and $76.8 million, respectively. Cash and cash equivalents are available to fund new investments, reduce borrowings under the Wells Facility and WestLB Facility, pay operating expenses and pay dividends. To date, our primary sources of capital have been from our IPO, use of our Wells Facility and WestLB Facility and the private placement for $50 million of equity capital completed on March 4, 2008.

The WestLB Facility had a three year initial revolving term and on March 3, 2011 the revolving term ended. The balance as of September 30, 2011 of $66 million will be amortized based on loan investment payments received through March 3, 2015.

As of September 30, 2011, we had available borrowing capacity of approximately $59.2 million under our Wells Facility, subject to existing terms and advance rates.

Our operating activities used cash of $32.4 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. Such cash was provided primarily from proceeds from our initial public offering and draws under the Wells Facility and WestLB Facility.

Our operating activities used cash of $15.5 million for the nine months ended September 30, 2010, and our financing activities provided net cash proceeds of $24.8 million for the same period. Our operating activities used cash primarily for investing in portfolio companies that was provided primarily from our availability on our WestLB Facility.

Our primary use of available funds will be investments in portfolio companies and cash distributions to holders of our common stock. After we have used our current capital resources, including the net proceeds from our initial public offering, we will seek to opportunistically raise additional 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.

We had sought qualification as an SBIC for Longview SBIC LP ("Longview SBIC"), a subsidiary, which would have been licensed, leveraged and regulated by the SBA. We, on behalf of Longview SBIC, submitted an application to the SBA on December 6, 2010 for a license to operate as an SBIC (the "SBIC Application") and the SBA accepted the SBIC Application for processing on December 21, 2010. We previously announced on May 10, 2011 that the SBA had requested additional information in support of the application and that the application process was suspended until such time as the information was provided. Horizon provided all of the information that it possessed with respect to such request and attempted to obtain additional information to satisfy such request. The SBA informed us that the information provided with respect to such request was not sufficient for the SBA to proceed with the application process. Accordingly, on September 14, 2011, we withdrew our application for an SBIC license.

The additional information that we were unable to provide the SBA relates to specific details concerning a regulatory inquiry that I. Joseph Massoud received. Mr. Massoud is not a current or former employee, officer or board member of the Company or our Advisor. Mr. Massoud is an indirect minority owner of the Advisor. The Company has been advised by Mr. Massoud that the regulatory inquiry is unrelated to Company or the Advisor, and neither the Company nor the Advisor has had any involvement in that regulatory inquiry. The SBA has indicated that we may petition the SBA for permission to file a new application for an SBIC license should further information for disclosure to the SBA become available to us.

Current Borrowings

We, through our wholly owned subsidiary, Credit I, entered into the WestLB Facility. Per this agreement, base rate borrowings bear interest at one-month LIBOR (0.24% as of September 30, 2011 and 0.26% as of December 31, 2010) plus 2.50%. The rates were 2.74% and 2.76% as of September 30, 2011 and December 31, 2010, 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. Per this agreement, 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 was 5.0% as of September 30, 2011.

We may request advances under the Wells Facility (the “Revolving Period”) through July 14 2014. 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. 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 and warrants 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.

Interest Rate Swaps and Hedging Activities

In 2008, we entered into two interest rate swap agreements with WestLB, fixing the rate of $10 million at 3.58% and $15 million at 3.2% on the first advances of a like amount of variable rate WestLB Facility borrowings. As of September 30, 2011, only the $10 million interest rate swap was still outstanding and expires in October 2011.

Contractual Obligations and Off-Balance Sheet Arrangements

A summary of our significant contractual payment obligations as of September 30, 2011 is as follows:

	Payments due by period (in thousands)				
Contractual Obligations	Total	Less than 1 year	1 - 3 years	3 - 5 years	After 5 years
Borrowings	$ 81,885	$ 36,278	$ 45,607	$ —	$ —
Unfunded commitments	18,667	9,834	8,833	—	—
Total contractual obligations	$ 100,552	$ 46,112	$ 54,440	$ —	$ —

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, 2011, we had unfunded commitments of approximately $18.7 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 Wells Facility and WestLB Facility, 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 any administrative 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 net stockholders on an annual basis. Additionally, we must distribute at least 98% of our ordinary income and 98% (or, for our taxable years beginning in 2011, 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 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 our portfolio investments. Prior to our election to become a BDC, loan investments were stated at current unpaid principal balances adjusted for the allowance for loan losses, unearned income and any unamortized deferred fees or costs.

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.

See Note 5 — Fair Value to the Consolidated Financial Statements for further information regarding fair value.

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.

Allowance for Loan Losses

Prior to our election to become a BDC, the allowance for loan losses represented management's estimate of probable loan losses inherent in the loan portfolio as of the balance sheet date. The estimation of the allowance was based on a variety of factors, including past loan loss experience, the current credit profile of our borrowers, adverse situations that had occurred that may affect individual borrowers' ability to repay, the estimated value of underlying collateral and general economic conditions. The loan portfolio is comprised of large balance loans that are evaluated individually for impairment and are risk-rated based upon a borrower's individual situation, current economic conditions, collateral and industry-specific information that management believes is relevant in determining the potential occurrence of a loss event and in measuring impairment. The allowance for loan losses was sensitive to the risk rating assigned to each of the loans and to corresponding qualitative loss factors that we used to estimate the allowance. Those factors were applied to the outstanding loan balances in estimating the allowance for loan losses. If necessary, based on performance factors related to specific loans, specific allowances for loan losses were established for individual impaired loans. Increases or decreases to the allowance for loan losses were charged or credited to current period earnings through the provision (credit) for loan losses. Amounts determined to be uncollectible were charged against the allowance for loan losses, while amounts recovered on previously charged-off loans increased the allowance for loan losses.

A loan was considered impaired when, based on current information and events, it was probable that we were unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment included payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experienced insignificant payment delays and payment shortfalls generally were not classified as impaired. Management determined the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment was measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s observable market price or the fair value of the collateral, if the loan was collateral dependent.

Impaired loans also included loans modified in troubled debt restructurings where concessions had been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

Income taxes

We have elected to be treated as a RIC under subchapter M of the Code and to 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. For the nine months ended September 30, 2011 no amount was recorded for U.S. federal excise tax.

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, 2011 and December 31, 2010.

Prior to our election to become a BDC, we were a limited liability company treated as a partnership for U.S. federal income tax purposes and, as a result, all items of income and expense were passed through to, and are generally reportable on, the tax returns of the respective members of the limited liability company. Therefore, no federal or state income tax provision has been recorded for the nine months ended September 30, 2010.

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 amendments are to be applied prospectively and are effective for interim and annual periods beginning after December 15, 2011. Management is currently evaluating the effect that the provisions of ASU 2011-04 will have on the Company’s financial statements.

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 all 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 balance sheet as of September 30, 2011 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 balance sheet 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.

Our Wells Facility and WestLB Facility have floating interest rate provisions based on a LIBOR index which resets daily, and we expect that, other than any SBIC debenture program debt, 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 if there is not a corresponding increase in interest income generated by floating rate assets in our investment portfolio.

Item 4: Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures.

As of September 30, 2011, 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.

Although we may, from time to time, be involved in litigation arising out of our operations in the normal course of business or otherwise, we are currently not a party to any pending material legal proceedings.

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, 2010, 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, 2011 to the risk factors discussed in “Item 1A. Risk Factors” in our annual report on Form 10-K for the year ended December 31, 2010.

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

None.

Item 3: Defaults Upon Senior Securities.

None.

Item 4: Removed and Reserved.

Item 5: Other Information.

None.

Item 6: Exhibits.

EXHIBIT INDEX

Number	Description
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 9, 2011	By:	/s/ Robert D. Pomeroy, Jr.	
		Name:	Robert D. Pomeroy, Jr.
		Title:	Chief Executive Officer
Date: November 9, 2011	By:	/s/ Christopher M. Mathieu	
		Name:	Christopher M. Mathieu
		Title:	Chief Financial Officer