

Horizon Technology Finance Corp  
Form 10-Q  
November 05, 2013

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

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

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2013**

**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**

**06032**

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*(Address of principal executive offices)*

*(Zip Code)*

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

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

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

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

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

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

As of November 5, 2013, the Registrant had 9,592,875 shares of common stock, \$0.001 par value, outstanding.

**HORIZON TECHNOLOGY FINANCE CORPORATION**

**FORM 10-Q**

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**PART I: FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****Horizon Technology Finance Corporation and Subsidiaries****Consolidated Statements of Assets and Liabilities (Unaudited)****(In thousands, except share data)**

|   | September<br>30,<br>2013 | December<br>31,<br>2012 |
|---|--------------------------|-------------------------|
| <b>Assets</b>   |                          |                         |
| Non-affiliate investments at fair value (cost of \$248,095 and \$239,385, respectively) (Note 4)  | \$ 241,319               | \$ 228,613              |
| Investment in money market funds  | 25,019                   | 2,560                   |
| Cash  | 2,439                    | 1,048                   |
| Restricted investments in money market funds  | 3,568                    | —                       |
| Interest receivable   | 4,119                    | 2,811                   |
| Other assets  | 5,391                    | 4,626                   |
| <b>Total assets</b>   | <b>\$ 281,855</b>        | <b>\$ 239,658</b>       |
| <b>Liabilities</b>  |                          |                         |
| Borrowings (Note 6)   | \$ 133,000               | \$ 89,020               |
| Dividends payable   | 3,308                    | 3,301                   |
| Base management fee payable (Note 3)  | 326                      | 402                     |
| Incentive fee payable (Note 3)  | 872                      | 855                     |
| Other accrued expenses  | 965                      | 1,108                   |
| <b>Total liabilities</b>  | <b>138,471</b>           | <b>94,686</b>           |
| <b>Net assets</b>   |                          |                         |
| Preferred stock, par value \$0.001 per share, 1,000,000 shares authorized, zero shares issued and outstanding as of September 30, 2013 and December 31, 2012                      | —                        | —                       |
| Common stock, par value \$0.001 per share, 100,000,000 shares authorized, 9,588,993 and 9,567,225 shares outstanding as of September 30, 2013 and December 31, 2012, respectively | 10                       | 10                      |
| Paid-in capital in excess of par  | 154,696                  | 154,384                 |
| Accumulated undistributed net investment income   | 1,371                    | 1,428                   |
| Net unrealized depreciation on investments  | (6,776 )                 | (10,772 )               |

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|                                  |           |           |
|----------------------------------|-----------|-----------|
| Net realized loss on investments | (5,917 )  | (78 )     |
| Total net assets                 | 143,384   | 144,972   |
| Total liabilities and net assets | \$281,855 | \$239,658 |
| Net asset value per common share | \$14.95   | \$15.15   |

See Notes to Consolidated Financial Statements

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

|   | For the Three Months Ended<br>September 30, |           | For the Nine Months Ended<br>September 30, |           |
|---|---|-----------|--|-----------|
|   | 2013  | 2012      | 2013                                       | 2012      |
| Investment income   |   |           |  |           |
| Interest income on non-affiliate investments              | \$ 8,225                                    | \$ 6,426  | \$ 23,979                                  | \$ 17,803 |
| Fee income on non-affiliate investments                   | 487   | 193       | 889  | 923       |
| Total investment income                                   | 8,712                                       | 6,619     | 24,868                                     | 18,726    |
| Expenses  |   |           |  |           |
| Interest expense  | 2,189                                       | 1,089     | 5,886                                      | 2,754     |
| Base management fee (Note 3)                              | 1,266                                       | 1,087     | 3,836                                      | 3,042     |
| Performance based incentive fee (Note 3)                  | 872   | 742       | 2,465                                      | 1,992     |
| Administrative fee (Note 3)                               | 287   | 352       | 889  | 854       |
| Professional fees   | 284   | 147       | 977  | 746       |
| General and administrative                                | 247   | 233       | 793  | 758       |
| Total expenses  | 5,145                                       | 3,650     | 14,846                                     | 10,146    |
| Net investment income before excise tax                   | 3,567                                       | 2,969     | 10,022                                     | 8,580     |
| Provision for excise tax                                  | (80)  | —         | (160)                                      | —         |
| Net investment income                                     | 3,487                                       | 2,969     | 9,862                                      | 8,580     |
| Net realized and unrealized (loss) gain on investments    |   |           |  |           |
| Net realized loss on investments                          | (5,566)                                     | —         | (5,839)                                    | (61)      |
| Net unrealized appreciation (depreciation) on investments | 5,967                                       | 677       | 3,996                                      | (117)     |
| Net realized and unrealized gain (loss) on investments    | 401   | 677       | (1,843)                                    | (178)     |
| Net increase in net assets resulting from operations      | \$ 3,888                                    | \$ 3,646  | \$ 8,019                                   | \$ 8,402  |
| Net investment income per common share                    | \$ 0.36                                     | \$ 0.33   | \$ 1.03                                    | \$ 1.06   |
| Net increase in net assets per common share               | \$ 0.41                                     | \$ 0.40   | \$ 0.84                                    | \$ 1.03   |
| Dividends declared per share                              | \$ 0.345                                    | \$ 0.45   | \$ 1.035                                   | \$ 1.35   |
| Weighted average shares outstanding                       | 9,584,376                                   | 9,078,010 | 9,577,912                                  | 8,121,986 |

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)**

|   | Shares    | Stock | Paid-In<br>Common<br>Capital in<br>Excess of<br>Par | Accumulated<br>Undistributed<br>Net<br>Investment<br>Income | Net Unrealized<br>Depreciation<br>on<br>Investments | Net Realized<br>Gains<br>(Losses) on<br>Investments | Total Net<br>Assets |
|---|-----------|-------|---|---|---|---|---------------------|
| Balance at December 31, 2011                                    | 7,636,532 | \$ 8  | \$ 124,512  | \$ 4,965  | \$ (2,659 )   | \$ 3,058  | \$ 129,884          |
| Issuance of common stock (net of offering costs) <sup>(1)</sup> | 1,909,000 | 2     | 29,543  | —   | —   | —   | 29,545              |
| Net increase in net assets resulting from operations            | —         | —     | —   | 8,580   | (117 )  | (61 )   | 8,402               |
| Issuance of common stock under dividend reinvestment plan       | 17,424    | —     | 288   | —   | —   | —   | 288                 |
| Dividends declared  | —         | —     | —   | (11,173 )   | —   | —   | (11,173 )           |
| Balance at September 30, 2012                                   | 9,562,956 | \$ 10 | \$ 154,343  | \$ 2,372  | \$ (2,776 )   | \$ 2,997  | \$ 156,946          |
| Balance at December 31, 2012                                    | 9,567,225 | \$ 10 | \$ 154,384  | \$ 1,428  | \$ (10,772 )  | \$ (78 )  | \$ 144,972          |
| Net increase in net assets resulting from operations            | —         | —     | —   | 9,862   | 3,996   | (5,839 )  | 8,019               |
| Issuance of common stock under dividend reinvestment plan       | 21,768    | —     | 312   | —   | —   | —   | 312                 |
| Dividends declared  | —         | —     | —   | (9,919 )  | —   | —   | (9,919 )            |
| Balance at September 30, 2013                                   | 9,588,993 | \$ 10 | \$ 154,696  | \$ 1,371  | \$ (6,776 )   | \$ (5,917 )   | \$ 143,384          |

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

See Notes to Consolidated Financial Statements

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

|   | For the Nine Months Ended<br>September 30, |           |
|---|--|-----------|
|   | 2013                                       | 2012      |
| Cash flows from operating activities:   |  |           |
| Net increase in net assets resulting from operations  | \$ 8,019                                   | \$ 8,402  |
| Adjustments to reconcile net increase in net assets resulting from operations to net cash used in operating activities: |  |           |
| Amortization of debt issuance costs   | 902  | 286       |
| Net realized loss on investments  | 5,629                                      | 61        |
| Net unrealized (appreciation) depreciation on investments   | (3,996 )                                   | 117       |
| Purchase of investments   | (69,143 )                                  | (86,720 ) |
| Principal payments received on investments  | 55,954                                     | 44,186    |
| Proceeds from sale on investments   | 39   | 38        |
| Changes in assets and liabilities:  |  |           |
| Net (increase) decrease in investments in money market funds  | (22,459 )                                  | 11,152    |
| Net increase in restricted investments in money market funds  | (3,568 )                                   | —         |
| Increase in interest receivable   | (160 )                                     | (70 )     |
| Increase in end-of-term payments  | (1,148 )                                   | (1,011 )  |
| Decrease in unearned loan income  | (1,190 )                                   | (578 )    |
| Decrease in other assets  | 458  | 16        |
| Decrease in other accrued expenses  | (143 )                                     | (260 )    |
| (Decrease) increase in base management fee payable  | (76 )                                      | 62        |
| Increase (decrease) in incentive fee payable  | 17   | (1,024 )  |
| Net cash used in operating activities   | (30,865 )                                  | (25,343 ) |
| Cash flows from financing activities:   |  |           |
| Proceeds from issuance of 2019 Notes  | —  | 33,000    |
| Proceeds from shares sold, net of offering cost   | —  | 29,545    |
| Proceeds from issuance of Asset-Backed Notes  | 90,000                                     | —         |
| Dividends paid  | (9,599 )                                   | (10,885 ) |
| Net decrease in Credit Facilities   | (46,020 )                                  | (21,320 ) |
| Debt issuance costs   | (2,125 )                                   | (3,007 )  |
| Net cash provided by financing activities   | 32,256                                     | 27,333    |
| Net increase in cash  | 1,391                                      | 1,990     |
| Cash:   |  |           |
| Beginning of period   | 1,048                                      | 1,298     |
| End of period   | \$ 2,439                                   | \$ 3,288  |



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Supplemental disclosure of cash flow information:

|   |          |          |
|---|----------|----------|
| Cash paid for interest  | \$ 4,982 | \$ 2,395 |
| Supplemental non-cash investing and financing activities:       |          |          |
| Warrant investments received & recorded as unearned loan income | \$ 626   | \$ 1,120 |
| Dividends Payable   | \$ 3,308 | \$ —     |

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments (Unaudited)****September 30, 2013****(In thousands)**

| Portfolio Company (1)                       | Sector         | Type of Investment (3)(4)(7)                    | Prin<br>Am |
|---|----------------|---|------------|
| Debt Investments — 161.6% (9)               |                |   |            |
| Debt Investments — Life Science — 29.3% (9) |                |   |            |
| ACT Biotech Corporation (8)                 | Biotechnology  | Term Loan (13.10% cash, 8.00% ETP, Due 9/1/14)  | \$3,9      |
| Celsion Corporation (2)(5)                  | Biotechnology  | Term Loan (11.75% cash, Due 10/1/15)            | 2,         |
| Inotek Pharmaceuticals Corporation (2)      | Biotechnology  | Term Loan (11.00% cash, 3.00% ETP, Due 10/1/16) | 3,5        |
| N30 Pharmaceuticals, LLC (2)                | Biotechnology  | Term Loan (11.25% cash, 3.00% ETP, Due 9/1/14)  | 99         |
|   |                | Term Loan (11.25% cash, 3.00% ETP, Due 10/1/15) | 2,5        |
| New Haven Pharmaceuticals, Inc. (2)         | Biotechnology  | Term Loan (11.50% cash, 3.00% ETP, Due 5/1/16)  | 1,5        |
|   |                | Term Loan (11.50% cash, 3.00% ETP, Due 5/1/16)  | 50         |
| Sample6, Inc. (2)                           | Biotechnology  | Term Loan (11.00% cash, 3.00% ETP, Due 1/1/16)  | 2,5        |
| Sunesis Pharmaceuticals, Inc. (2)(5)        | Biotechnology  | Term Loan (8.95% cash, 3.75% ETP, Due 10/1/15)  | 1,0        |
|   |                | Term Loan (9.00% cash, 3.75% ETP, Due 10/1/15)  | 2,4        |
| Xcovery Holding Company, LLC (2)            | Biotechnology  | Term Loan (12.50% cash, Due 8/1/15)             | 88         |
|   |                | Term Loan (12.50% cash, Due 8/1/15)             | 1,3        |
|   |                | Term Loan (12.50% cash, Due 10/1/15)            | 25         |
| Direct Flow Medical, Inc. (2)               | Medical Device | Term Loan (11.00% cash, 3.00% ETP, Due 7/1/16)  | 5,0        |
|   |                | Term Loan (11.00% cash, 3.00% ETP, Due 10/1/16) | 2,5        |
| Mitralign, Inc. (2)                         | Medical Device | Term Loan (12.00% cash, 3.00% ETP, Due 10/1/15) | 1,7        |
|   |                | Term Loan (10.88% cash, 3.00% ETP, Due 11/1/15) | 1,         |
|   |                | Term Loan (10.50% cash, 3.00% ETP, Due 7/1/16)  | 1,         |
| PixelOptics, Inc. (2)(8)                    | Medical Device | Term Loan (10.75% cash, 3.00% ETP, Due 11/1/14) | 5,0        |
| Tengion, Inc. (2)(5)                        | Medical Device | Term Loan (13.00% cash, Due 5/1/14)             | 2,3        |
| Tryton Medical, Inc.                        | Medical Device | Term Loan (10.41% cash, 2.50% ETP, Due 9/1/16)  | 3,0        |
| Total Debt Investments — Life Science       |                |   |            |
| Debt Investments — Technology — 94.3% (9)   |                |   |            |
| Avalanche Technology, Inc. (2)              | Semiconductors | Term Loan (10.00% cash, 2.00% ETP, Due 7/1/16)  | 3,2        |
| eASIC Corporation                           | Semiconductors | Term Loan (11.00% cash, 2.50% ETP, Due 4/1/17)  | 2,0        |
| Kaminario, Inc. (2)                         | Semiconductors | Term Loan (10.50% cash, 2.50% ETP, Due 11/1/16) | 3,0        |
|   |                | Term Loan (10.50% cash, 2.50% ETP, Due 11/1/16) | 3,0        |
| Luxtera, Inc. (2)                           | Semiconductors | Term Loan (10.25% cash, 8.00% ETP, Due 12/1/15) | 3,0        |
|   |                | Term Loan (10.25% cash, 8.00% ETP, Due 3/1/16)  | 1,0        |
| Newport Media, Inc. (2)                     | Semiconductors | Term Loan (11.00% cash, 2.14% ETP, Due 1/1/16)  | 3,5        |
|   |                | Term Loan (11.00% cash, 2.14% ETP, Due 1/1/16)  | 3,5        |

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|  |                    |   |     |
|--|--------------------|---|-----|
| NexPlanar Corporation (2)                    | Semiconductors     | Term Loan (10.50% cash, 2.50% ETP, Due 12/1/16) | 3,0 |
|  |                    | Term Loan (10.50% cash, 2.50% ETP, Due 12/1/16) | 2,0 |
| Xtera Communications, Inc. (2)               | Semiconductors     | Term Loan (11.50% cash, Due 3/1/15)             | 6,8 |
|  |                    | Term Loan (11.50% cash, Due 10/1/15)            | 1,7 |
| Ekahau, Inc.                                 | Communications     | Term Loan (11.75% cash, 2.50% ETP, Due 2/1/17)  | 1,5 |
| Overture Networks, Inc. (2)                  | Communications     | Term Loan (10.75% cash, 4.75% ETP, Due 12/1/16) | 5,0 |
| Optaros, Inc. (2)                            | Internet and Media | Term Loan (11.95% cash, 3.00% ETP, Due 10/1/15) | 1,3 |
|  |                    | Term Loan (11.95% cash, 3.00% ETP, Due 3/1/16)  | 50  |
| SimpleTuition, Inc. (2)                      | Internet and Media | Term Loan (11.75% cash, Due 3/1/16)             | 4,2 |
| Bolt Solutions, Inc. (2)                     | Software           | Term Loan (11.65% cash, 4.00% ETP, Due 5/1/16)  | 5,0 |
|  |                    | Term Loan (11.65% cash, 4.00% ETP, Due 5/1/16)  | 5,0 |
| Construction Software Technologies, Inc. (2) | Software           | Term Loan (11.75% cash, 5.00% ETP, Due 10/1/16) | 4,2 |
|  |                    | Term Loan (11.75% cash, 5.00% ETP, Due 10/1/16) | 4,2 |
| Courion Corporation (2)                      | Software           | Term Loan (11.45% cash, Due 10/1/15)            | 2,9 |
|  |                    | Term Loan (11.45% cash, Due 10/1/15)            | 2,9 |
| Decisyon, Inc. (2)                           | Software           | Term Loan (11.65% cash, 5.00% ETP, Due 9/1/16)  | 4,0 |
| Fiberlink Communications Corporation (2)     | Software           | Term Loan (11.50% cash, 5.00% ETP, Due 7/1/16)  | 5,0 |
|  |                    | Term Loan (11.50% cash, 5.00% ETP, Due 12/1/16) | 3,0 |
| Kontera Technologies, Inc. (2)               | Software           | Term Loan (11.50% cash, 3.00% ETP, Due 10/1/16) | 4,0 |
|  |                    | Term Loan (11.50% cash, 3.00% ETP, Due 10/1/16) | 4,0 |
| Lotame Solutions, Inc.                       | Software           | Term Loan (11.50% cash, 3.00% ETP, Due 10/1/16) | 4,0 |
|  |                    | Term Loan (11.50% cash, 3.00% ETP, Due 9/1/19)  | 1,5 |
| Netuitive, Inc. (2)                          | Software           | Term Loan (11.75% cash, Due 1/1/16)             | 2,0 |
| Raydiance, Inc. (2)                          | Software           | Term Loan (11.50% cash, 2.75% ETP, Due 9/1/16)  | 5,0 |
|  |                    | Term Loan (11.50% cash, 2.75% ETP, Due 9/1/16)  | 1,0 |
| Razorsight Corporation (2)                   | Software           | Term Loan (11.75% cash, 3.00% ETP, Due 11/1/16) | 1,5 |
|  |                    | Term Loan (11.75% cash, 3.00% ETP, Due 9/1/16)  | 1,5 |
| Sys-Tech Solutions, Inc. (2)                 | Software           | Term Loan (11.65% cash, Due 6/1/16)             | 7,4 |
| Vidsys, Inc. (2)                             | Software           | Term Loan (11.00% cash, 6.50% ETP, Due 6/1/16)  | 3,0 |
| Visage Mobile, Inc. (2)                      | Software           | Term Loan (12.00% cash, 3.50% ETP, Due 9/1/16)  | 1,0 |

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments (Unaudited)****September 30, 2013****(In thousands)**

| Portfolio Company (1)  | Sector             | Type of Investment (3)(4)(7)   |
|--|--------------------|--|
| Aquion Energy, Inc. (2)  | Power Management   | Term Loan (10.25% cash, 4.00% ETP, Due<br>Term Loan (10.25% cash, 4.00% ETP, Due<br>Term Loan (10.25% cash, 4.00% ETP, Due |
| Xtreme Power, Inc. (2)   | Power Management   | Term Loan (10.75% cash, 3.50% ETP, Due   |
| Total Debt Investments — Technology                                |                    |  |
| Debt Investments — Cleantech — 20.0% (9)                           |                    |  |
| Renmatix, Inc. (2)   | Alternative Energy | Term Loan (10.25% cash, 3.00% ETP, Due<br>Term Loan (10.25% cash, 3.00% ETP, Due<br>Term Loan (10.25% cash, Due 10/1/16)   |
| Semprius, Inc. (2)   | Alternative Energy | Term Loan (10.25% cash, 2.50% ETP, Due   |
| Cereplast, Inc. (5)(8)   | Waste Recycling    | Term Loan (12.00% cash, Due 8/1/14)<br>Term Loan (12.00% cash, Due 8/1/14)   |
| Aurora Algae, Inc. (2)   | Energy Efficiency  | Term Loan (10.50% cash, 2.00% ETP, Due   |
| Rypos, Inc.  | Energy Efficiency  | Term Loan (11.80% cash, Due 1/1/17)  |
| Solarbridge Technologies, Inc. (2)                                 | Energy Efficiency  | Term Loan (12.15% cash, 3.21 ETP, Due 4/   |
| Tigo Energy, Inc. (2)  | Energy Efficiency  | Term Loan (13.00% cash, Due 6/1/15)<br>Revolver (13.75% (Prime + 7.50%) cash, Du   |
| Total Debt Investments — Cleantech                                 |                    |  |
| Debt Investments — Healthcare information and services — 18.0% (9) |                    |  |
| BioScale, Inc. (2)   | Diagnostics        | Term Loan (11.51% cash, Due 1/1/14)  |
| Radisphere National Radiology Group, Inc. (2)                      | Diagnostics        | Revolver (11.25% (Prime + 8.00%) cash, Du  |
| Recondo Technology, Inc. (2)                                       | Software           | Term Loan (11.50% cash, 3.00% ETP, Due<br>Term Loan (11.00% cash, 3.00% ETP, Due   |
| Watermark Medical, Inc. (2)  | Other Healthcare   | Term Loan (12.00% cash, 4.00% ETP, Due<br>Term Loan (12.00% cash, 4.00% ETP, Due   |
| Total Debt Investments — Healthcare information and services       |                    |  |
| Total Debt Investments   |                    |  |
| Warrant Investments — 4.6% (9)                                     |                    |  |
| Warrants — Life Science — 1.4% (9)                                 |                    |  |
| ACT Biotech Corporation  | Biotechnology      | 1,521,782 Preferred Stock Warrants   |
| Ambit Biosciences, Inc.(5)   | Biotechnology      | 44,795 Common Stock Warrants   |
| Anacor Pharmaceuticals, Inc. (2)(5)                                | Biotechnology      | 84,583 Common Stock Warrants   |
| Celsion Corporation (5)  | Biotechnology      | 25,685 Common Stock Warrants   |

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|                                       |                               |                                    |
|---------------------------------------|-------------------------------|------------------------------------|
| Inotek, Pharmaceuticals Corporation   | Biotechnology                 | 114,387 Preferred Stock Warrants   |
| N30 Pharmaceuticals, LLC              | Biotechnology                 | 214,200 Preferred Stock Warrants   |
| New Haven Pharmaceuticals, Inc.       | Biotechnology                 | 34,729 Preferred Stock Warrants    |
| Revance Therapeutics, Inc.            | Biotechnology                 | 687,091 Preferred Stock Warrants   |
| Sample6, Inc.                         | Biotechnology                 | 200,582 Preferred Stock Warrants   |
| Sunesis Pharmaceuticals, Inc. (5)     | Biotechnology                 | 116,203 Common Stock Warrants      |
| Supernus Pharmaceuticals, Inc. (2)(5) | Biotechnology                 | 42,083 Preferred Stock Warrants    |
| Tranzyme, Inc. (2)(5)                 | Biotechnology                 | 77,902 Common Stock Warrants       |
| Direct Flow Medical, Inc.             | Medical Device                | 176,922 Preferred Stock Warrants   |
| EnteroMedics, Inc. (5)                | Medical Device                | 141,026 Common Stock Warrants      |
| Mitralign, Inc.                       | Medical Device                | 295,238 Common Stock Warrants      |
| OraMetrix, Inc. (2)                   | Medical Device                | 812,348 Preferred Stock Warrants   |
| PixelOptics, Inc.                     | Medical Device                | 381,612 Preferred Stock Warrants   |
| Tengion, Inc. (2)(5)                  | Medical Device                | 1,708,273 Common Stock Warrants    |
| Tryton Medical, Inc.                  | Medical Device                | 47,977 Preferred Stock Warrants    |
| ViOptix, Inc.                         | Medical Device                | 375,763 Preferred Stock Warrants   |
| Total Warrants — Life Science         |                               |                                    |
| Warrants — Technology — 2.1% (9)      |                               |                                    |
| Ekahau, Inc.                          | Communications                | 978,261 Preferred Stock Warrants   |
| OpenPeak, Inc.                        | Communications                | 18,997 Preferred Stock Warrants    |
| Overture Networks, Inc.               | Communications                | 344,574 Preferred Stock Warrants   |
| Everyday Health, Inc.                 | Consumer-related Technologies | 65,674 Preferred Stock Warrants    |
| SnagAJob.com, Inc.                    | Consumer-related Technologies | 365,396 Preferred Stock Warrants   |
| Tagged, Inc.                          | Consumer-related Technologies | 190,868 Preferred Stock Warrants   |
| Avalanche Technology, Inc.            | Semiconductors                | 201,835 Preferred Stock Warrants   |
| eASIC Corporation`                    | Semi-conductor                | 1,877,799 Preferred Stock Warrants |
| Kaminario, Inc.                       | Semi-conductor                | 1,087,203 Preferred Stock Warrants |
| Luxtera, Inc.                         | Semiconductors                | 1,827,485 Preferred Stock Warrants |
| Newport Media, Inc.                   | Semiconductors                | 188,764 Preferred Stock Warrants   |

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments (Unaudited)****September 30, 2013****(In thousands)**

| Portfolio Company (1)                        | Sector             | Type of Investment (3)(4)(7)       | Principal Amount (6) | Cost of Investments (5) | Fair Value |
|--|--------------------|------------------------------------|----------------------|-------------------------|------------|
| NexPlanar Corporation                        | Semiconductors     | 172,801 Preferred Stock Warrants   | —                    | 36                      | 58         |
| Xtera Communications, Inc.                   | Semiconductors     | 983,607 Preferred Stock Warrants   | —                    | 206                     | 1          |
| XIOtech, Inc.                                | Data Storage       | 2,217,979 Preferred Stock Warrants | —                    | 22                      | 20         |
| Cartera Commerce, Inc.                       | Internet and media | 90,909 Preferred Stock Warrants    | —                    | 16                      | 16         |
| Optaros, Inc.                                | Internet and media | 477,403 Preferred Stock Warrants   | —                    | 21                      | 15         |
| SimpleTuition, Inc.                          | Internet and media | 189,573 Preferred Stock Warrants   | —                    | 63                      | 16         |
| IntelePeer, Inc.                             | Networking         | 141,549 Preferred Stock Warrants   | —                    | 39                      | 37         |
| Motion Computing, Inc.                       | Networking         | 260,707 Preferred Stock Warrants   | —                    | 7                       | 26         |
| Bolt Solutions, Inc.                         | Software           | 202,892 Preferred Stock Warrants   | —                    | 113                     | 12         |
| Clarabridge, Inc.                            | Software           | 104,503 Preferred Stock Warrants   | —                    | 28                      | 29         |
| Construction Software Technologies, Inc. (2) | Software           | 386,415 Preferred Stock Warrants   | —                    | 69                      | 32         |
| Courion Corporation                          | Software           | 772,543 Preferred Stock Warrants   | —                    | 106                     | 98         |
| Decisyon, Inc.                               | Software           | 314,686 Preferred Stock Warrants   | —                    | 44                      | 41         |
| DriveCam, Inc.                               | Software           | 71,639 Preferred Stock Warrants    | —                    | 20                      | 12         |
| Kontera Technologies, Inc. (2)               | Software           | 99,476 Preferred Stock Warrants    | —                    | 102                     | 88         |
| Lotame Solutions, Inc.                       | Software           | 216,810 Preferred Stock Warrants   | —                    | 4                       | 4          |
| Netuitive, Inc.                              | Software           | 748,453 Preferred Stock Warrants   | —                    | 75                      | 56         |
| Raydiance, Inc.                              | Software           | 735,784 Preferred Stock Warrants   | —                    | 51                      | 52         |
| Razorsight Corporation                       | Software           | 194,553 Preferred Stock Warrants   | —                    | 34                      | 32         |
| Sys-Tech Solutions, Inc.                     | Software           | 375,000 Preferred Stock Warrants   | —                    | 242                     | 23         |
| Vidsys, Inc.                                 | Software           | 37,346 Preferred Stock Warrants    | —                    | 23                      | 7          |
| Visage Mobile, Inc.                          | Software           | 1,692,047 Preferred Stock Warrants | —                    | 20                      | 19         |
| Aquion Energy, Inc.                          | Power Management   | 115,051 Preferred Stock Warrants   | —                    | 7                       | 61         |
| Xtreme Power, Inc.                           | Power Management   | 182,723 Preferred Stock Warrants   | —                    | 76                      | 59         |
| Total Warrants — Technology                  |                    |                                    |                      | 1,914                   | 2,         |
| Warrants — Cleantech — 0.5% (9)              |                    |                                    |                      |                         |            |
| Renmatix, Inc.                               | Alternative Energy | 52,296 Preferred Stock Warrants    | —                    | 68                      | 73         |
| Semprius, Inc.                               | Alternative Energy | 519,981 Preferred Stock Warrants   | —                    | 25                      | 23         |
| Cereplast, Inc. (5)                          | Waste Recycling    | 365,000 Common Stock Warrants      | —                    | 175                     | —          |
| Enphase Energy, Inc. (5)                     | Energy Efficiency  | 161,959 Common Stock Warrants      | —                    | 175                     | 35         |
| Rypos, Inc.                                  | Energy Efficiency  | 5,627 Preferred Stock Warrants     | —                    | 44                      | 44         |
| Solarbridge Technologies, Inc. (2)           | Energy Efficiency  | 3,645,302 Preferred Stock Warrants | —                    | 236                     | 21         |
| Tigo Energy, Inc. (2)                        | Energy Efficiency  | 804,604 Preferred Stock Warrants   | —                    | 100                     | 28         |

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|   |                  |                                  |           |      |
|---|------------------|----------------------------------|-----------|------|
| Total Warrants — Cleantech                                |                  |                                  | 823       | 73   |
| Warrants — Healthcare information and services — 0.6% (9) |                  |                                  |           |      |
| Accumetrics, Inc.   | Diagnostics      | 100,928 Preferred Stock Warrants | — 107     | 82   |
| BioScale, Inc. (2)  | Diagnostics      | 315,618 Preferred Stock Warrants | — 54      | —    |
| Precision Therapeutics, Inc.                              | Diagnostics      | 13,461 Preferred Stock Warrants  | — 73      | —    |
| Radisphere National Radiology Group, Inc. (2)             | Diagnostics      | 519,943 Preferred Stock Warrants | — 378     | 36   |
| Recondo Technology, Inc.                                  | Software         | 360,645 Preferred Stock Warrants | — 62      | 16   |
| Patientkeeper, Inc.                                       | Other Healthcare | 396,410 Preferred Stock Warrants | — 269     | 32   |
| Singulex, Inc.  | Other Healthcare | 293,632 Preferred Stock Warrants | — 44      | 14   |
| Talyst, Inc.  | Other Healthcare | 300,360 Preferred Stock Warrants | — 100     | 58   |
| Watermark Medical, Inc.                                   | Other Healthcare | 12,216 Preferred Stock Warrants  | — 66      | 68   |
| Total Warrants — Healthcare information and services      |                  |                                  | 1,153     | 91   |
| Total Warrants  |                  |                                  | 5,683     | 6,   |
| Other Investments — 1.4% (9)                              |                  |                                  |           |      |
| Vette Technology, LLC                                     | Data Storage     | Royalty Agreement Due 4/18/2019  | — 4,760   | 2,   |
| Total Other Investments                                   |                  |                                  | 4,760     | 2,   |
| Equity — 0.7% (9)   |                  |                                  |           |      |
| Insmed Incorporated (5)                                   | Biotechnology    | 33,208 Common Stock              | — 227     | 51   |
| Revance Therapeutics, Inc.                                | Biotechnology    | 72,925 Preferred Stock           | — 73      | 10   |
| Overture Networks Inc.                                    | Communications   | 386,191 Common Stock             | — 482     | 42   |
| Cereplast, Inc. (5)                                       | Waste Recycling  | 200,000 Common Stock             | — —       | —    |
| Total Equity  |                  |                                  | 782       | 1,   |
| Total Portfolio Investment Assets — 168.3% (9)            |                  |                                  | \$248,095 | \$24 |

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments (Unaudited)****September 30, 2013****(In thousands)**

| Portfolio Company (1)                                 | Sector | Type of Investment<br>(3)(4)(7)                       | Principal Cost of<br>Amount Investments<br>(6) | Fair<br>Value |
|---|--------|---|--|---------------|
| Short Term Investments — Money Market Funds — 17.4%   |        |   |  |               |
| (9)   |        |   |  |               |
|   |        | Blackrock Liquid Fed Funds Institutional (Fund #30)   | \$ 22,741                                      | \$22,741      |
|   |        | Fidelity Prime Money Market (Class I Fund #690)       | 91   | 91            |
|   |        | US Bank Money Market                                  | 2,187  | 2,187         |
|   |        | Total Short Term Investments — Money Market Funds     | \$ 25,019                                      | \$25,019      |
| Short Term Investments — Restricted Investments— 2.5% |        |   |  |               |
| (9)   |        |   |  |               |
|   |        | US Bank Money Market (2)                              | \$ 3,568                                       | \$3,568       |
|   |        | Total Short Term Investments — Restricted Investments | \$ 3,568                                       | \$3,568       |

(1) All of the Company's investments are in entities which are domiciled in the United States and/or have a principal place of business in the United States.

(2) Has been pledged as collateral under the Credit Facilities or Asset-Backed Notes.

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

All interest is payable in cash due monthly in arrears, unless otherwise indicated, and applies only to the Company's debt investments. Interest rate is the annual interest rate on the debt investment and does not include ETP and any (4) additional fees related to the investments, such as deferred interest, commitment fees or prepayment fees. All debt investments are at fixed rates for the term of the loan, unless otherwise indicated. For each debt investment, the current interest rate in effect as of September 30, 2013 is provided.

(5) Portfolio company is a public company.



- (6) For debt investments, represents principal balance less unearned income.
- (7) Preferred and common stock warrants, equity interests and other investments are non-income producing.
- (8) Debt is on non-accrual status at September 30, 2013 and is, therefore, considered non-income producing.
- (9) Value as a percent of net assets.

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments (Unaudited)****December 31, 2012****(In thousands)**

| Portfolio Company (1)                       | Sector         | Type of Investment (3)(4)(7)                        |
|---|----------------|---|
| Debt Investments — 152.0% (9)               |                |   |
| Debt Investments — Life Science — 42.4% (9) |                |   |
| ACT Biotech Corporation (8)                 | Biotechnology  | Term Loan (13.10% cash, 8.00% ETP, Due 9/1/14)      |
| Ambit Biosciences Corporation (2)           | Biotechnology  | Term Loan (12.25% cash, 3.00% ETP, Due 10/1/13)     |
| Anacor Pharmaceuticals, Inc. (2)(5)         | Biotechnology  | Term Loan (9.41% cash, 5.50% ETP, Due 4/1/15)       |
|   |                | Term Loan (9.67% cash, 5.50% ETP, Due 4/1/15)       |
|   |                | Term Loan (9.47% cash, 5.50% ETP, Due 4/1/15)       |
| Celsion Corporation (2)(5)                  | Biotechnology  | Term Loan (11.75% cash, Due 10/1/15)                |
| N30 Pharmaceuticals, LLC (2)                | Biotechnology  | Term Loan (11.25% cash, 3.00% ETP, Due 9/1/14)      |
|   |                | Term Loan (11.25% cash, 3.00% ETP, Due 7/1/15)      |
| Revance Therapeutics, Inc.                  | Biotechnology  | Convertible Note (8.00% ETP, Due 2/10/13)           |
| Sample6 Technologies, Inc. (2)              | Biotechnology  | Term Loan (11.00% cash, 3.00% ETP, Due 1/1/16)      |
| Sunesis Pharmaceuticals, Inc. (2)(5)        | Biotechnology  | Term Loan (8.95% cash, 3.75% ETP, Due 10/1/15)      |
|   |                | Term Loan (9.00% cash, 3.75% ETP, Due 10/1/15)      |
| Supernus Pharmaceuticals, Inc. (2)(5)       | Biotechnology  | Term Loan (11.00% cash, 3.00% ETP, Due 8/1/14)      |
|   |                | Term Loan (11.00% cash, 2.50% ETP, Due 1/1/15)      |
| Xcovery Holding Company, LLC (2)            | Biotechnology  | Term Loan (12.50% cash, Due 8/1/15)                 |
|   |                | Term Loan (12.50% cash, Due 8/1/15)                 |
|   |                | Term Loan (12.50% cash, Due 10/1/15)                |
| Direct Flow Medical, Inc. (2)               | Medical Device | Term Loan (11.00% cash, 3.00% ETP, Due 7/1/16)      |
| Mitralign, Inc. (2)                         | Medical Device | Term Loan (12.00% cash, 3.00% ETP, Due 10/1/15)     |
|   |                | Term Loan (10.88% cash, 3.00% ETP, Due 11/1/15)     |
| OraMetrix, Inc. (2)                         | Medical Device | Term Loan (11.50% cash, 3.00% ETP, Due 4/1/14)      |
|   |                | Revolver (11.50% (Prime + 8.25%) cash, Due 12/1/15) |
| PixelOptics, Inc. (2)                       | Medical Device | Term Loan (10.75% cash, 3.00% ETP, Due 11/1/14)     |
| Tengion, Inc. (2)(5)                        | Medical Device | Term Loan (13.00% cash, Due 5/1/14)                 |
| Total Debt Investments — Life Science       |                |   |
| Debt Investments — Technology — 72.9% (9)   |                |   |
| Avalanche Technology, Inc. (2)              | Semiconductors | Term Loan (10.00% cash, 2.00% ETP, Due 7/1/16)      |
| Luxtera, Inc. (2)                           | Semiconductors | Term Loan (10.25% cash, 8.00% ETP, Due 12/1/15)     |
|   |                | Term Loan (10.25% cash, 8.00% ETP, Due 3/1/16)      |
| Newport Media, Inc. (2)                     | Semiconductors | Term Loan (11.00% cash, 2.14% ETP, Due 1/1/16)      |

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|  |                    |   |
|--|--------------------|---|
|  |                    | Term Loan (11.00% cash, 2.14% ETP, Due 1/1/16)  |
| Xtera Communications, Inc. (2)               | Semiconductors     | Term Loan (11.50% cash, Due 12/1/14)            |
|  |                    | Term Loan (11.50% cash, Due 7/1/15)             |
| Grab Networks, Inc. (2)                      | Internet and Media | Term Loan (12.00% cash, Due 1/1/16)             |
| Optaros, Inc. (2)                            | Internet and Media | Term Loan (11.95% cash, 3.00% ETP, Due 10/1/15) |
|  |                    | Term Loan (11.95% cash, 3.00% ETP, Due 3/1/16)  |
| SimpleTuition, Inc. (2)                      | Internet and Media | Term Loan (11.75% cash, Due 3/1/16)             |
| Construction Software Technologies, Inc. (2) | Software           | Term Loan (11.75% cash, 5.00% ETP, Due 10/1/16) |
|  |                    | Term Loan (11.75% cash, 5.00% ETP, Due 10/1/16) |
| Courion Corporation (2)                      | Software           | Term Loan (11.45% cash, Due 10/1/15)            |
|  |                    | Term Loan (11.45% cash, Due 10/1/15)            |
| Fiberlink Communications Corporation (2)     | Software           | Term Loan (11.50% cash, 5.00% ETP, Due 7/1/16)  |
| Kontera Technologies, Inc. (2)               | Software           | Term Loan (11.50% cash, 3.00% ETP, Due 10/1/16) |
|  |                    | Term Loan (11.50% cash, 3.00% ETP, Due 10/1/16) |
| Netuitive, Inc. (2)                          | Software           | Term Loan (11.75% cash, Due 1/1/16)             |
| Seapass Solutions, Inc. (2)                  | Software           | Term Loan (11.65% cash, 4.00% ETP, Due 5/1/16)  |
|  |                    | Term Loan (11.65% cash, 4.00% ETP, Due 5/1/16)  |
| StreamBase Systems, Inc. (2)                 | Software           | Term Loan (12.51% cash, Due 11/1/13)            |
|  |                    | Term Loan (12.50% cash, Due 6/1/14)             |
|  |                    | Term Loan (12.50% cash, Due 12/1/15)            |
| Sys-Tech Solutions, Inc. (2)                 | Software           | Term Loan (11.65% cash, Due 6/1/16)             |
| Vidsys, Inc. (2)                             | Software           | Term Loan (11.00% cash, 5.00% ETP, Due 6/1/16)  |
| Aquion Energy, Inc. (2)                      | Power Management   | Term Loan (10.25% cash, 4.00% ETP, Due 3/1/16)  |
|  |                    | Term Loan (10.25% cash, 4.00% ETP, Due 3/1/16)  |
|  |                    | Term Loan (10.25% cash, 4.00% ETP, Due 6/1/16)  |
| Xtreme Power, Inc. (2)                       | Power Management   | Term Loan (10.75% cash, 3.50% ETP, Due 5/1/16)  |
| Total Debt Investments — Technology          |                    |   |

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries****Consolidated Schedule of Investments (Unaudited)****December 31, 2012****(In thousands)**

| Portfolio Company (1)  | Sector             | Type of Investment (3)(4)(7)   |
|--|--------------------|--|
| Debt Investments — Cleantech — 16.4% (9)                           |                    |  |
| Renmatix, Inc. (2)   | Alternative Energy | Term Loan (10.25% cash, 3.00% ETP, Du<br>Term Loan (10.25% cash, 3.00% ETP, Du   |
| Semprius, Inc. (2)   | Alternative Energy | Term Loan (10.25% cash, 2.50% ETP, Du  |
| Cereplast, Inc. (5)(8)   | Waste Recycling    | Term Loan (12.00% cash, Due 8/1/14)<br>Term Loan (12.00% cash, Due 8/1/14)<br>Term Loan (15.00% cash, Due 4/4/13)<br>Term Loan (15.00% cash, Due 4/4/13) |
| Aurora Algae, Inc. (2)   | Energy Efficiency  | Term Loan (10.50% cash, 2.00% ETP, Du  |
| Satcon Technology Corporation (5)(8)                               | Energy Efficiency  | Term Loan (12.58% cash, Due 1/1/14)  |
| Solarbridge Technologies, Inc. (2)                                 | Energy Efficiency  | Term Loan (11.65% cash, Due 4/1/16)  |
| Tigo Energy, Inc. (2)  | Energy Efficiency  | Term Loan (11.00% cash, Due 8/1/14)<br>Revolver (10.75% (Prime + 7.50%) cash, )  |
| Total Debt Investments — Cleantech                                 |                    |  |
| Debt Investments — Healthcare information and services — 20.3% (9) |                    |  |
| Accumetrics, Inc. (2)  | Diagnostics        | Term Loan (10.90% cash, 5.00% ETP, Du  |
| BioScale, Inc. (2)   | Diagnostics        | Term Loan (11.51% cash, Due 1/1/14)  |
| Radisphere National Radiology Group, Inc. (2)                      | Diagnostics        | Revolver (11.25% (Prime + 8.00%) cash, )   |
| Recondo Technology, Inc. (2)                                       | Software           | Term Loan (11.50% cash, 3.00% ETP, Du<br>Term Loan (11.00% cash, 3.00% ETP, Du<br>Revolver (10.50% (Prime + 7.25%) cash, )                               |
| Singulex, Inc.   | Other Healthcare   | Term Loan (11.00% cash, 3.00% ETP, Du<br>Term Loan (11.00% cash, 3.00% ETP, Du   |
| Total Debt Investments — Healthcare information and services       |                    |  |
| Total Debt Investments   |                    |  |
| Warrant Investments — 3.8% (9)                                     |                    |  |
| Warrants — Life Science — 1.1% (9)                                 |                    |  |
| ACT Biotech Corporation  | Biotechnology      | 1,390,910 Preferred Stock Warrants   |
| Ambit Biosciences, Inc. (2)  | Biotechnology      | 1,075,083 Preferred Stock Warrants   |
| Anacor Pharmaceuticals, Inc. (2)(5)                                | Biotechnology      | 84,583 Common Stock Warrants   |
| Anesiva, Inc.  | Biotechnology      | 198,898 Common Stock Warrants  |
| Celsion Corporation (2)(5)   | Biotechnology      | 25,685 Common Stock Warrants   |
| N30 Pharmaceuticals, LLC (2)                                       | Biotechnology      | 214,200 Preferred Stock Warrants   |

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|                                       |                               |                                    |
|---------------------------------------|-------------------------------|------------------------------------|
| Novalar Pharmaceuticals, Inc.         | Biotechnology                 | 84,845 Preferred Stock Warrants    |
| Revanche Therapeutics, Inc.           | Biotechnology                 | 199,470 Preferred Stock Warrants   |
| Sample6 Technologies, Inc. (2)        | Biotechnology                 | 200,582 Preferred Stock Warrants   |
| Sunesis Pharmaceuticals, Inc. (2)(5)  | Biotechnology                 | 116,203 Common Stock Warrants      |
| Supernus Pharmaceuticals, Inc. (2)(5) | Biotechnology                 | 42,083 Preferred Stock Warrants    |
| Tranzyme, Inc. (2)(5)                 | Biotechnology                 | 77,902 Common Stock Warrants       |
| Direct Flow Medical, Inc. (2)         | Medical Device                | 176,922 Preferred Stock Warrants   |
| EnteroMedics, Inc. (5)                | Medical Device                | 141,026 Common Stock Warrants      |
| Mitralign, Inc. (2)                   | Medical Device                | 295,238 Common Stock Warrants      |
| OraMetrix, Inc. (2)                   | Medical Device                | 812,348 Preferred Stock Warrants   |
| PixelOptics, Inc. (2)                 | Medical Device                | 381,612 Preferred Stock Warrants   |
| Tengion, Inc. (2)(5)                  | Medical Device                | 1,716,339 Common Stock Warrants    |
| ViOptix, Inc.                         | Medical Device                | 375,763 Preferred Stock Warrants   |
| Total Warrants — Life Science         |                               |                                    |
| Warrants — Technology — 1.9% (9)      |                               |                                    |
| OpenPeak, Inc.                        | Communications                | 18,997 Preferred Stock Warrants    |
| Everyday Health, Inc.                 | Consumer-related Technologies | 65,674 Preferred Stock Warrants    |
| SnagAJob.com, Inc.                    | Consumer-related Technologies | 365,396 Preferred Stock Warrants   |
| Tagged, Inc.                          | Consumer-related Technologies | 190,868 Preferred Stock Warrants   |
| Avalanche Technology, Inc. (2)        | Semiconductors                | 201,835 Preferred Stock Warrants   |
| Impinj, Inc.                          | Semi-conductor                | 1 Preferred Stock Warrants         |
| Luxtera, Inc. (2)                     | Semiconductors                | 1,827,485 Preferred Stock Warrants |
| Newport Media, Inc. (2)               | Semiconductors                | 188,764 Preferred Stock Warrants   |
| Xtera Communications, Inc. (2)        | Semiconductors                | 983,607 Preferred Stock Warrants   |

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| Portfolio Company (1)                                     | Sector             | Type of Investment (3)(4)(7)       | Principal Amount | Cost of Investments | Fair Value |
|---|--------------------|------------------------------------|------------------|---------------------|------------|
| XIOtech, Inc.   | Data Storage       | 2,217,979 Preferred Stock Warrants | —                | 22                  | —          |
| Cartera Commerce, Inc.                                    | Internet and media | 90,909 Preferred Stock Warrants    | —                | 16                  | —          |
| Grab Networks, Inc. (2)                                   | Internet and media | 1,493,681 Preferred Stock Warrants | —                | 194                 | —          |
| Optaros, Inc. (2)   | Internet and media | 477,403 Preferred Stock Warrants   | —                | 20                  | —          |
| SimpleTuition, Inc. (2)                                   | Internet and media | 189,573 Preferred Stock Warrants   | —                | 63                  | —          |
| IntelePeer, Inc.  | Networking         | 141,549 Preferred Stock Warrants   | —                | 39                  | —          |
| Motion Computing, Inc.                                    | Networking         | 260,707 Preferred Stock Warrants   | —                | 7                   | —          |
| Clarabridge, Inc.   | Software           | 104,503 Preferred Stock Warrants   | —                | 28                  | —          |
| Construction Software Technologies, Inc. (2)              | Software           | 386,415 Preferred Stock Warrants   | —                | 69                  | —          |
| Courion Corporation (2)                                   | Software           | 772,543 Preferred Stock Warrants   | —                | 107                 | —          |
| DriveCam, Inc.  | Software           | 71,639 Preferred Stock Warrants    | —                | 19                  | —          |
| Kontera Technologies, Inc. (2)                            | Software           | 99,476 Preferred Stock Warrants    | —                | 101                 | —          |
| Netuitive, Inc. (2)                                       | Software           | 748,453 Preferred Stock Warrants   | —                | 75                  | —          |
| Seapass Solutions, Inc. (2)                               | Software           | 202,892 Preferred Stock Warrants   | —                | 113                 | —          |
| StreamBase Systems, Inc. (2)                              | Software           | 306,041 Preferred Stock Warrants   | —                | 83                  | —          |
| Sys-Tech Solutions, Inc. (2)                              | Software           | 375,000 Preferred Stock Warrants   | —                | 242                 | —          |
| Vidsys, Inc. (2)  | Software           | 178,802 Preferred Stock Warrants   | —                | 23                  | —          |
| Aquion Energy, Inc. (2)                                   | Power Management   | 82,644 Preferred Stock Warrants    | —                | 7                   | —          |
| Xtreme Power, Inc. (2)                                    | Power Management   | 182,723 Preferred Stock Warrants   | —                | 76                  | —          |
| Total Warrants — Technology                               |                    |                                    |                  | 1,844               |            |
| Warrants — Cleantech — 0.2% (9)                           |                    |                                    |                  |                     |            |
| Renmatix, Inc. (2)  | Alternative Energy | 52,296 Preferred Stock Warrants    | —                | 69                  | —          |
| Semprius, Inc. (2)  | Alternative Energy | 519,981 Preferred Stock Warrants   | —                | 25                  | —          |
| Cereplast, Inc. (5)                                       | Waste Recycling    | 365,000 Common Stock Warrants      | —                | 175                 | —          |
| Enphase Energy, Inc. (5)                                  | Energy Efficiency  | 161,959 Common Stock Warrants      | —                | 176                 | —          |
| Satcon Technology Corporation (5)                         | Energy Efficiency  | 493,097 Common Stock Warrants      | —                | 285                 | —          |
| Solarbridge Technologies, Inc. (2)                        | Energy Efficiency  | 1,761,051 Preferred Stock Warrants | —                | 125                 | —          |
| Tigo Energy, Inc. (2)                                     | Energy Efficiency  | 190,901 Preferred Stock Warrants   | —                | 101                 | —          |
| Total Warrants — Cleantech                                |                    |                                    |                  | 956                 |            |
| Warrants — Healthcare information and services — 0.6% (9) |                    |                                    |                  |                     |            |
| Accumetrics, Inc. (2)                                     | Diagnostics        | 1,028,57 Preferred Stock Warrants  | —                | 107                 | —          |
| BioScale, Inc. (2)  | Diagnostics        | 315,618 Preferred Stock Warrants   | —                | 55                  | —          |
| Precision Therapeutics, Inc.                              | Diagnostics        | 561,409 Preferred Stock Warrants   | —                | 73                  | —          |
| Radisphere National Radiology Group, Inc. (2)             | Diagnostics        | 519,943 Preferred Stock Warrants   | —                | 378                 | —          |

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|  |                  |                                  |   |              |
|--|------------------|----------------------------------|---|--------------|
| Recondo Technology, Inc. (2)                         | Software         | 360,645 Preferred Stock Warrants | — | 60           |
| Patientkeeper, Inc.                                  | Other Healthcare | 396,410 Preferred Stock Warrants | — | 269          |
| Singulex, Inc.                                       | Other Healthcare | 293,632 Preferred Stock Warrants | — | 44           |
| Talyst, Inc.   | Other Healthcare | 300,360 Preferred Stock Warrants | — | 100          |
| Total Warrants — Healthcare information and services |                  |                                  |   | 1,086        |
| Total Warrants                                       |                  |                                  |   | 5,715        |
| Other Investments — 1.4% (9)                         |                  |                                  |   |              |
| Vette Technology, LLC                                | Data Storage     | Royalty Agreement Due 4/18/2019  |   | 4,880        |
| Total Other Investments                              |                  |                                  |   | 4,880        |
| Equity — 0.5% (9)                                    |                  |                                  |   |              |
| Insmmed Incorporated (5)                             | Biotechnology    | 33,208 Common Stock              |   | 227          |
| Overture Networks Inc.                               | Communications   | 386,191 Preferred Stock          |   | 482          |
| Total Equity   |                  |                                  |   | 709          |
| Total Portfolio Investment Assets — 157.7% (9)       |                  |                                  |   | \$239,385 \$ |

See Notes to Consolidated Financial Statements

**Horizon Technology Finance Corporation and Subsidiaries**

**Consolidated Schedule of Investments (Unaudited)**

**December 31, 2012**

**(In thousands)**

| Portfolio Company (1)                                  | Sector | Type of Investment (3)(4)(7)                             | Principal Amount | Cost of Investments (6) | Fair Value     |
|--|--------|--|------------------|-------------------------|----------------|
| Short Term Investments — Money Market Funds — 1.8% (9) |        |  |                  |                         |                |
|  |        | Blackrock Liquid Fed Funds Institutional (Fund #30)      |                  | \$ 2,197                | \$2,197        |
|  |        | Fidelity Prime Money Market (Class I Fund #690)          |                  | 91                      | 91             |
|  |        | US Bank Money Market                                     |                  | 272                     | 272            |
|  |        | <b>Total Short Term Investments — Money Market Funds</b> |                  | <b>\$ 2,560</b>         | <b>\$2,560</b> |

(1) All of the Company's investments are in entities which are domiciled in the United States and/or have a principal place of business in the United States.

(2) Has been pledged as collateral under the Credit Facilities.

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

All interest is payable in cash due monthly in arrears, unless otherwise indicated, and applies only to the Company's debt investments. Interest rate is the annual interest rate on the debt investment and does not include ETP and any additional fees related to the investments, such as deferred interest, commitment fees or prepayment fees. All debt investments are at fixed rates for the term of the loan, unless otherwise indicated. For each debt investment, the current interest rate in effect as of December 31, 2012 is provided.

(5) Portfolio company is a public company.

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

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



(8) Debt is on non-accrual status at December 31, 2012 and is, therefore, considered non-income producing.

(9) Value as a percent of net assets.

See Notes to Consolidated Financial Statements

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

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

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

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

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

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

Horizon Credit I LLC (“Credit I”) was formed as a Delaware limited liability company on January 23, 2008, with CHF as the sole equity member. Credit I is a special purpose bankruptcy remote entity and is a separate legal entity from the Company and CHF. There has been no activity in Credit I during the nine months ended September 30, 2013.

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

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

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

The Company formed Horizon Funding 2013-1 LLC (“2013-1 LLC”) as a Delaware limited liability company on June 7, 2013 and Horizon Funding Trust 2013-1 (“2013-1 Trust” and, together with the 2013-1 LLC, the “2013-1 Entities”) as a Delaware trust on June 18, 2013. The 2013-1 Entities are special purpose bankruptcy remote entities and are separate legal entities from the Company. The Company formed the 2013-1 Entities for purposes of securitizing \$189.3 million of secured loans and issuing fixed-rate asset-backed notes in an aggregate principal amount of \$90 million (the “Asset-Backed Notes”).

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

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

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

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

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

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

The accompanying 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. The current period’s results of operations are not necessarily indicative of results that ultimately may be achieved for the year. Therefore, the unaudited financial statements and related notes should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2012.

##### *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 investments.

### *Fair Value*

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

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.

#### *Investments*

Investments are recorded at fair value. The Company's board of directors (the "Board") determines the fair value of its portfolio investments. The Company intends to hold its debt investments 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. Generally, 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. As of September 30, 2013, there were three investments on non-accrual status with a cost of \$11.1 million and a fair value of \$7.1 million. As of December 31, 2012, there were three investments on non-accrual status with a cost of \$12.9 million and a fair value of \$4.9 million.

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 ("ETP"), which is accrued into interest 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 of the Company's 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 or losses from the disposition of the warrants or stock acquired from the exercise of warrants are recognized as realized gains or losses on investments.

Realized gains or losses on the sale of investments, or upon the determination that an investment balance, or portion thereof, is not recoverable, are calculated using the specific identification method. The Company measures realized gains or losses by calculating the difference between the net proceeds from the repayment or sale and the amortized cost basis of the investment. Net change in unrealized appreciation or depreciation reflects the change in the fair values of our portfolio investments during the reporting period, including any reversal of previously recorded unrealized appreciation or depreciation, when gains or losses are realized.

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

Debt issuance costs are fees and other direct incremental costs incurred by the Company in obtaining debt financing from its lenders and issuing debt securities. Debt issuance costs are recognized as assets and are amortized as interest expense over the term of the related credit facility. The unamortized balance of debt issuance costs as of September 30, 2013 and December 31, 2012, included in other assets, was \$4.9 million and \$3.7 million, respectively. The accumulated amortization balance of debt issuance cost as of September 30, 2013 and December 31, 2012 was \$1.5 million and \$0.6 million, respectively. The amortization expense for the nine months ended September 30, 2013 and 2012 was \$0.9 and \$0.3 million, respectively.

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

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

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

#### ***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, 2013, \$0.2 million was recorded for U.S. federal excise tax. For the nine months ended September 30, 2012, 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, 2013 and December 31, 2012. The 2012, 2011 and 2010 tax years remain subject to examination by U.S. federal and state tax authorities.

#### ***Dividends***

Dividends 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 long-term capital gains, if any, are distributed at least annually, although the



Company may decide to retain such capital gains for investment.

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

### *Transfers of Financial Assets*

Assets related to transactions that do not meet ASC Topic 860 — *Transfers and Servicing* requirements for accounting sale treatment are reflected in the Company’s consolidated statements of financial condition as investments. Those assets are owned by special purpose entities that are consolidated in the Company’s financial statements. The creditors of the special purpose entities have received security interests in such assets and such assets are not intended to be available to the creditors of the Company (or any affiliate of the Company).

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, which was renewed by the Board in August 2013, 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 adviser with the U.S. Securities and Exchange Commission. The Advisor receives fees for providing services, consisting of two components, a base management fee and an incentive fee.

The base management fee under the Investment Management Agreement is calculated at an annual rate of 2.00% of the Company's gross assets, payable monthly in arrears. For purposes of calculating the base management fee, the term "gross assets" includes any assets acquired with the proceeds of leverage. The management fee payable at September 30, 2013 and December 31, 2012 was \$0.3 million and \$0.4 million, respectively. The base management fee expense was \$1.3 million and \$1.1 million for the three months ended September 30, 2013 and 2012, respectively. The base management fee expense was \$3.8 million and \$3.0 million for the nine months ended September 30, 2013 and 2012, 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 the Company has 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.

## Horizon Technology Finance Corporation and Subsidiaries

### Notes to Consolidated Financial Statements

(In thousands, except shares and per share data)

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

The performance based incentive fee expense was \$0.9 million and \$0.7 million for the three months ended September 30, 2013 and 2012, respectively. The performance based incentive fee expense was \$2.5 million and \$2.0 million for the nine months ended September 30, 2013 and 2012, respectively. The entire performance based incentive fee expense for both the three and nine months ended September 30, 2013 and 2012, represents part one of the incentive fee. The incentive fee payable for both September 30, 2013 and December 31, 2012 was \$0.9 million. The entire incentive fee payable as of September 30, 2013 and December 31, 2012 represents part one of the incentive fee.

#### *Administration Agreement*

The Company entered into an administration agreement (the "Administration Agreement") with the Advisor to provide administrative services to the Company. For providing these services, facilities and personnel, the Company reimburses 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 months ended September 30, 2013 and 2012, \$0.3 million and \$0.4 million were charged to operations under the Administration Agreement, respectively. For both the nine months ended September 30, 2013 and 2012, \$0.9 million was charged to operations under the Administration Agreement.

#### **Note 4. Investments**

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

|                                 | September 30, 2013 |            | December 31, 2012 |            |
|---------------------------------|--------------------|------------|-------------------|------------|
|                                 | Cost               | Fair Value | Cost              | Fair Value |
| Money market funds              | \$25,019           | \$25,019   | \$2,560           | \$2,560    |
| Restricted investments          | \$3,568            | \$3,568    | \$—               | \$—        |
| Non-affiliate investments       |                    |            |                   |            |
| Debt                            | \$236,870          | \$231,661  | \$228,081         | \$220,297  |
| Warrants                        | 5,683              | 6,611      | 5,715             | 5,468      |
| Other Investments               | 4,760              | 2,000      | 4,880             | 2,100      |
| Equity                          | 782                | 1,047      | 709               | 748        |
| Total non-affiliate investments | \$248,095          | \$241,319  | \$239,385         | \$228,613  |

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

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

|                                     | September 30, 2013 |            | December 31, 2012 |            |
|-------------------------------------|--------------------|------------|-------------------|------------|
|                                     | Cost               | Fair Value | Cost              | Fair Value |
| Life Science                        |                    |            |                   |            |
| Biotechnology                       | \$25,074           | \$ 25,073  | \$40,358          | \$ 39,569  |
| Medical Device                      | 22,475             | 19,609     | 24,296            | 23,733     |
| Technology                          |                    |            |                   |            |
| Consumer-Related Technologies       | 118                | 436        | 118               | 445        |
| Networking                          | 46                 | 304        | 46                | 774        |
| Software                            | 72,884             | 73,449     | 55,220            | 55,237     |
| Data Storage                        | 4,782              | 2,020      | 4,901             | 2,121      |
| Internet and Media                  | 6,679              | 6,770      | 10,056            | 10,118     |
| Communications                      | 6,956              | 6,805      | 571               | 526        |
| Semiconductors                      | 36,542             | 36,401     | 26,128            | 25,913     |
| Power Management                    | 15,182             | 14,409     | 15,875            | 15,864     |
| Cleantech                           |                    |            |                   |            |
| Energy Efficiency                   | 15,102             | 14,791     | 18,914            | 13,138     |
| Waste Recycling                     | 2,394              | 1,629      | 3,744             | 2,199      |
| Alternative Energy                  | 12,934             | 12,937     | 8,680             | 8,683      |
| Healthcare Information and Services |                    |            |                   |            |
| Diagnostics                         | 15,421             | 15,256     | 21,952            | 21,921     |
| Other Healthcare Related Services   | 7,373              | 7,193      | 3,067             | 2,829      |
| Software                            | 4,133              | 4,237      | 5,459             | 5,543      |
| Total non-affiliate investments     | \$248,095          | \$ 241,319 | \$239,385         | \$ 228,613 |

**Note 5. Fair Value**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for certain assets or liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value

or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

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

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

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

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

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

## Horizon Technology Finance Corporation and Subsidiaries

### Notes to Consolidated Financial Statements

(In thousands, except shares and per share data)

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

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

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

*Debt Investments:* For variable rate debt investments which re-price frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values. The fair value of fixed rate debt investments is estimated by discounting the expected future cash flows using the year end rates at which similar debt investments would be made to borrowers with similar credit ratings and for the same remaining maturities. At both September 30, 2013 and December 31, 2012, the discount rates used ranged from 9% to 25%. Significant increases (decreases) in this unobservable input would result in a significantly lower (higher) fair value measurement. These assets are recorded at fair value on a recurring basis and are categorized as Level 3 within the fair value hierarchy described above.

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



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

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

Volatility, or the amount of uncertainty or risk about the size of the changes in the warrant price, is based on guideline publicly traded companies within indices similar in nature to the underlying company issuing the warrant. A total of seven such indices were used. Significant increases (decreases) in this unobservable input would result in a significantly higher (lower) fair value investment.

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. Significant increases (decreases) in this unobservable input would result in significantly lower (higher) fair value measurement.

Historical portfolio experience on cancellations and exercises of warrants are utilized as the basis for determining the estimated time to exit of the warrants in each financial reporting period. Warrants may be exercised in the event of acquisitions, mergers or IPOs, and cancelled due to events such as bankruptcies, restructuring activities or additional financings. These events cause the expected remaining life assumption to be shorter than the contractual term of the warrants. Significant increases (decreases) in this unobservable input would result in significantly higher (lower) fair value measurement.

## Horizon Technology Finance Corporation and Subsidiaries

### Notes to Consolidated Financial Statements

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

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.

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

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

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

The following tables provide a summary of quantitative information about the Company's Level 3 fair value measurements of investments as of September 30, 2013 and December 31, 2012. In addition to the techniques and inputs noted in the table below, according to the Company's valuation policy the Company may also use other valuation techniques and methodologies when determining fair value measurements. The tables below are not intended to be all-inclusive, but rather provide information on the significant Level 3 inputs as they relate to the Company's fair value measurements:

## September 30, 2013

| Investment Type           | Fair Value | Valuation Techniques/<br>Methodologies        | Unobservable<br>Input   | Range  |
|---------------------------|------------|---|---|--|
| Debt investments          | \$224,557  | Discounted Expected Future Cash Flows         | Hypothetical Market Yield   | 9% - 25%                                       |
|                           | 7,104      | Multiple Probability Weighted Cash Flow Model | Discount Rate<br>Probability Weighting  | 25%– 33%<br>0% - 65%                           |
| Warrant investments       | 5,296      | Black-Scholes Valuation Model                 | Price per share<br>Average Industry<br>Volatility<br>Marketability Discount<br>Estimated Time to Exit | \$0.0 – \$63.98<br>21%<br>20%<br>1 to 10 years |
| Other investments         | 2,000      | Multiple Probability Weighted Cash Flow Model | Discount Rate<br>Probability Weighting  | 25%<br>10% - 45%                               |
| Equity investments        | 529        | Most Recent Equity Investment                 | Price Per Share   | \$1.09 – 1.50                                  |
| Total Level 3 investments | \$239,486  |   |   |  |

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

| December 31, 2012         |            |   |  |   |
|---------------------------|------------|---|--|---|
| Investment Type           | Fair Value | Valuation Techniques/<br>Methodologies        | Unobservable Input   | Range   |
| Debt investments          | \$215,396  | Discounted Expected Future Cash Flows         | Hypothetical Market Yield  | 8% - 25%                                      |
|                           | 4,901      | Multiple Probability Weighted Cash Flow Model | Discount Rate<br>Probability Weighting   | 25%<br>10% - 60%                              |
| Warrant investments       | 4,914      | Black-Scholes Valuation Model                 | Price per share<br>Average Industry Volatility<br>Marketability Discount<br>Estimated Time to Exit | \$0.0 - \$9.56<br>21%<br>20%<br>1 to 10 years |
| Other investments         | 2,100      | Multiple Probability Weighted Cash Flow Model | Discount Rate<br>Probability Weighting   | 25%<br>10% - 45%                              |
| Equity investments        | 526        | Market Comparable Companies                   | Revenue Multiple   | 1.5x - 2.0x                                   |
| Total Level 3 investments | \$227,837  |   |  |   |

*Borrowings:* The carrying amount of borrowings under the Credit Facilities (as defined in Note 6) approximates fair value due to the variable interest rate of the Credit Facilities and are categorized as Level 2 within the fair value hierarchy described above. Additionally, the Company considers its creditworthiness in determining the fair value of such borrowings. The fair value of the fixed rate 2019 Notes (as defined in Note 6) is based on the closing public share price on the date of measurement. At September 30, 2013, the 2019 Notes were trading on the New York Stock Exchange for \$25.42 per note, or \$33.6 million. Therefore, the Company has categorized this borrowing as Level 1 within the fair value hierarchy described above. Based on market quotations on or around September 30, 2013, the Asset-Backed Notes (as defined in Note 6) were trading for \$0.9930 per dollar at par value, or \$89.4 million, and are categorized as Level 3 with the fair value hierarchy described above. These liabilities are not recorded at fair value on a recurring basis.

*Off-Balance-Sheet Instruments:* Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the

counterparties' credit standings. Therefore, the Company has categorized these instruments as Level 3 within the fair value hierarchy described above.

The following tables detail the assets and liabilities that are carried at fair value and measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012 and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

|                        | September 30, 2013 |            |          |           |
|------------------------|--------------------|------------|----------|-----------|
|                        | Total              | Level<br>1 | Level 2  | Level 3   |
| Money market funds     | \$25,019           | \$—        | \$25,019 | \$—       |
| Restricted investments | \$3,568            | \$—        | \$3,568  | \$—       |
| Debt investments       | \$231,661          | \$—        | \$—      | \$131,661 |
| Warrant investments    | \$6,611            | \$—        | \$1,315  | \$5,296   |
| Other investments      | \$2,000            | \$—        | \$—      | \$2,000   |
| Equity investments     | \$1,047            | \$518      | \$—      | \$529     |

|                     | December 31, 2012 |            |            |           |
|---------------------|-------------------|------------|------------|-----------|
|                     | Total             | Level<br>1 | Level<br>2 | Level 3   |
| Money market funds  | \$2,560           | \$—        | \$2,560    | \$—       |
| Debt investments    | \$220,297         | \$—        | \$—        | \$220,297 |
| Warrant investments | \$5,468           | \$—        | \$554      | \$4,914   |
| Other investments   | \$2,100           | \$—        | \$—        | \$2,100   |
| Equity investments  | \$748             | \$222      | \$—        | \$526     |

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

The following tables show a reconciliation of the beginning and ending balances for Level 3 assets for the three months ended September 30, 2013:

|   | Three Months Ended September 30, 2013 |                     |                    |                   | Total     |
|---|---------------------------------------|---------------------|--------------------|-------------------|-----------|
|   | Debt Investments                      | Warrant Investments | Equity Investments | Other Investments |           |
| Level 3 assets, beginning of period                         | \$237,871                             | \$ 5,150            | \$ 529             | \$ 2,100          | \$245,650 |
| Purchase of investments                                     | 11,500                                | —                   | —                  | —                 | 11,500    |
| Warrants and equity received and classified as Level 3      | —                                     | 200                 | —                  | —                 | 200       |
| Principal payments received on investments                  | (17,986 )                             | —                   | —                  | (33 )             | (18,019 ) |
| Unrealized appreciation (depreciation) included in earnings | 4,844                                 | 216                 | —                  | (67 )             | 4,993     |
| Realized loss included in earnings                          | (5,010 )                              | (270 )              | —                  | —                 | (5,280 )  |
| Other   | 442                                   | —                   | —                  | —                 | 442       |
| Level 3 assets, end of period                               | \$231,661                             | \$ 5,296            | \$ 529             | \$ 2,000          | \$239,486 |

During the three months ended September 30, 2013, there were no transfers between levels.

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

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

The following tables show a reconciliation of the beginning and ending balances for Level 3 assets for the nine months ended September 30, 2013:

|   | Nine Months Ended September 30, 2013 |                     |                    |                   | Total     |
|---|--------------------------------------|---------------------|--------------------|-------------------|-----------|
|   | Debt Investments                     | Warrant Investments | Equity Investments | Other Investments |           |
| Level 3 assets, beginning of period                         | \$220,297                            | \$ 4,914            | \$ 526             | \$ 2,100          | \$227,837 |
| Purchase of investments                                     | 69,143                               | —                   | —                  | —                 | 69,143    |
| Warrants and equity received and classified as Level 3      | —                                    | 626                 | —                  | —                 | 626       |
| Principal payments received on investments                  | (55,921 )                            | —                   | —                  | (33 )             | (55,954 ) |
| Proceeds from sale of warrants                              | —                                    | (39 )               | —                  | —                 | (39 )     |
| Unrealized appreciation (depreciation) included in earnings | 2,595                                | 226                 | (70 )              | (67 )             | 2,684     |
| Realized loss included in earnings                          | (5,010 )                             | (315 )              | —                  | —                 | (5,325 )  |
| Transfer out of Level 3                                     | —                                    | (116 )              | —                  | —                 | (116 )    |
| Transfer from debt to equity investment                     | (73 )                                | —                   | 73                 | —                 | —         |
| Other   | 630                                  | —                   | —                  | —                 | 630       |
| Level 3 assets, end of period                               | \$231,661                            | \$ 5,296            | \$ 529             | \$ 2,000          | \$239,486 |

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

The Company's transfers between levels are recognized at the end of the reporting period. During the nine months ended September 30, 2013, there were no transfers between Level 1 and Level 2. The transfer out of Level 3 relates to warrants held in one portfolio company, with a value of \$0.1 million, that were transferred into Level 2 due to the portfolio company becoming a public company during the nine months ended September 30, 2013. Because warrants held in publicly traded companies are determined based on inputs that are readily available in public markets or can be derived from information available in public markets, the Company has categorized the warrants as Level 2 within the fair value hierarchy described above as of September 30, 2013.

The change in unrealized appreciation included in the consolidated statement of operations attributable to Level 3 investments still held at September 30, 2013 includes \$2.7 million unrealized depreciation on loans, \$0.1 million unrealized appreciation on warrants, \$0.1 million unrealized depreciation on equity and \$0.1 million unrealized depreciation on other investments.

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

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



categorized these warrants as of September 30, 2012 as Level 2 within the fair value hierarchy described above.

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

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

As of September 30, 2013 and December 31, 2012, the recorded book balances equaled fair values of all the Company's financial instruments, except for the Company's 2019 Notes and Asset-Backed Notes, as previously described.

#### *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 Company expects the fair values of its financial instruments to 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.

**Horizon Technology Finance Corporation and Subsidiaries****Notes to Consolidated Financial Statements****(In thousands, except shares and per share data)****Note 6. Borrowings**

A summary of the Company's borrowings as of September 30, 2013 and December 31, 2012 is as follows:

|                    | September 30, 2013  |                        |                      |
|--------------------|---------------------|------------------------|----------------------|
|                    | Total<br>Commitment | Balance<br>Outstanding | Unused<br>Commitment |
| Asset-Backed Notes | \$90,000            | \$ 90,000              | \$ —                 |
| Wells Facility     | 75,000              | —                      | 75,000               |
| Fortress Facility  | 75,000              | 10,000                 | 65,000               |
| 2019 Notes         | 33,000              | 33,000                 | —                    |
| Total              | \$273,000           | \$ 133,000             | \$ 140,000           |

|                   | December 31, 2012   |                        |                      |
|-------------------|---------------------|------------------------|----------------------|
|                   | Total<br>Commitment | Balance<br>Outstanding | Unused<br>Commitment |
| Wells Facility    | \$75,000            | \$ 46,020              | \$ 28,980            |
| Fortress Facility | 75,000              | 10,000                 | 65,000               |
| 2019 Notes        | 33,000              | 33,000                 | —                    |
| Total             | \$183,000           | \$ 89,020              | \$ 93,980            |

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, 2013, the asset coverage for borrowed amounts was 208%.

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 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 Wells Facility has a three-year revolving term followed by a three-year amortization period and matures on July 14, 2017. The interest rate was based upon the one-month LIBOR plus a spread of 4.00%, with a LIBOR floor of 1.00%. On May 28, 2013, the Company and Wells amended the Wells Facility. As amended, effective May 1, 2013, the stated interest rate was reduced to one-month LIBOR plus a spread of 3.25%, with a LIBOR floor of 1.00%. In general, all other terms and conditions of the Wells Facility remain unchanged. The rate at September 30, 2013 and December 31, 2012 was 4.25% and 5.0%, respectively. The average rate for the three months ended September 30, 2013 and 2012 was 4.25% and 5.0%, respectively. There were no amounts drawn on the Wells Facility during the three months ended September 30, 2013. The average rate for the nine months ended September 30, 2013 and 2012 was 4.8% and 5.0%, respectively. The average amount of borrowings were \$9.9 million for the three months ended September 30, 2012. The average amounts of borrowings were \$35.0 million and \$11.7 million for the nine months ended September 30, 2013 and 2012, respectively.

On March 23, 2012, the Company issued and sold an aggregate principal amount of \$30 million of 7.375% senior unsecured notes due in 2019, and, on April 18, 2012, pursuant to the underwriters' 30 day option to purchase additional notes, the Company sold an additional \$3 million of such notes (collectively, the "2019 Notes"). The 2019 Notes will mature on March 15, 2019 and may be redeemed in whole or in part at the Company's option at any time or from time to time on or after March 15, 2015 at a redemption price of \$25 per security plus accrued and unpaid interest. The 2019 Notes bear interest at a rate of 7.375% per year payable quarterly on March 15, June 15, September 15 and December 15 of each year. The 2019 Notes are the Company's direct unsecured obligations and (i) rank equally with the Company's future senior unsecured indebtedness; (ii) rank senior to any of the Company's future indebtedness that expressly provides it is subordinated to the 2019 Notes; (iii) are effectively subordinated to all of the Company's existing and future secured indebtedness (including indebtedness that is initially unsecured to which the Company subsequently grants security) to the extent of the value of the assets securing such indebtedness and (iv) are structurally subordinated to all existing and future indebtedness and other obligations of any of the Company's subsidiaries. As of September 30, 2013, the Company was in material compliance with the terms of the 2019 Notes. The 2019 Notes are listed on the New York Stock Exchange under the symbol "HTF."

## Horizon Technology Finance Corporation and Subsidiaries

### Notes to Consolidated Financial Statements

(In thousands, except shares and per share data)

The Company entered into a term loan credit facility (the “Fortress Facility” and, together with the Wells Facility, the “Credit Facilities”) with Fortress Credit Co LLC effective August 23, 2012. The Fortress Facility is collateralized by all loans and warrants held by Credit III. The Fortress Facility contains covenants that, among other things, require the Company to maintain a minimum net worth and to restrict the loans securing the Fortress Facility to certain criteria for qualified loans and includes portfolio company concentration limits as defined in the related loan agreement. The Fortress Facility, among other things, has a three-year term subject to two one-year extensions with a draw period of up to four years. The Fortress Facility requires the payment of an unused line fee in an amount equal to 1.00% of any unborrowed amount available under the facility annually and has an effective advance rate of 66% against eligible loans. The Fortress Facility generally bears interest based upon the one-month LIBOR plus a spread of 6.00%, with a LIBOR floor of 1.00%. The rate at both September 30, 2013 and December 31, 2012 was 7.00%, and the average rate for both the three and nine months ended September 30, 2013 was 7.00%. The average amount of borrowings was \$10.0 million for both the three and nine months ended September 30, 2013.

On June 28, 2013, the Company completed a \$189.3 million securitization of secured loans which it originated. 2013-1 Trust, a newly formed wholly owned subsidiary of the Company, issued \$90 million in aggregate principal amount of fixed-rate asset-backed notes (the “Asset-Backed Notes”), which are rated A2(sf) by Moody’s Investors Service, Inc. The Company is the sponsor, originator and servicer for the transaction. The Asset-Backed Notes bear interest at a fixed rate of 3.00% per annum and have a stated maturity of May 15, 2018.

The Asset-Backed Notes were issued by 2013-1 Trust pursuant to a Note Purchase Agreement (the “Note Purchase Agreement”), dated as of June 28, 2013, by and among the Company, 2013-1 LLC, as trust depositor, 2013-1 Trust and Guggenheim Securities, LLC (“Guggenheim Securities”), as initial purchaser, and are backed by a pool of loans made to certain portfolio companies of the Company and secured by certain assets of such portfolio companies. The pool of loans is to be serviced by the Company. In connection with the issuance and sale of the Asset-Backed Notes, the Company has made customary representations, warranties and covenants in the Note Purchase Agreement. The Asset-Backed Notes are secured obligations of 2013-1 Trust and are non-recourse to the Company.

As part of the transaction, the Company entered into a Sale and Contribution Agreement, dated as of June 28, 2013 (the “Sale and Contribution Agreement”), with 2013-1 LLC pursuant to which the Company has agreed to sell or has contributed to 2013-1 LLC certain secured loans made to certain portfolio companies of the Company (the “Loans”). The Company has made customary representations, warranties and covenants in the Sale and Contribution Agreement with respect to the Loans as of the date of the transfer of the Loans to 2013-1 LLC. The Company has also entered

into a sale and servicing agreement, dated as of June 28, 2013, with 2013-1 LLC and 2013-1 Trust pursuant to which 2013-1 LLC has agreed to sell or has contributed the Loans to 2013-1 Trust. The Company has made customary representations, warranties and covenants in the sale and servicing agreement. The Company will also serve as administrator to 2013-1 Trust pursuant to an administration agreement, dated as of June 28, 2013, with 2013-1 Trust, Wilmington Trust, National Association, and U.S. Bank National Association. 2013-1 Trust also entered into an indenture, dated as of June 28, 2013, which governs the Asset-Backed Notes and includes customary covenants and events of default. In addition, 2013-1 LLC entered into an amended and restated trust agreement, dated as of June 28, 2013, which includes customary representations, warranties and covenants. The Asset-Backed Notes were sold through an unregistered private placement to “qualified institutional buyers” in compliance with the exemption from registration provided by Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”), and to institutional “accredited investors” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) who, in each case, are “qualified purchasers” for purposes of Section 3(c)(7) under the 1940 Act.

On June 3, 2013, the Company and Guggenheim Securities entered into a Promissory Note (the “Promissory Note”) whereby Guggenheim Securities made a term loan in the original principal amount of \$15 million (the “Term Loan”) to the Company. The Company granted Guggenheim Securities a security interest in all of its assets to secure the Term Loan. On June 28, 2013, the Company used a portion of the proceeds of the private placement of the Asset-Backed Notes to repay all of its outstanding obligations under the Term Loan and the security interest of Guggenheim Securities was released.

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

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

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

Under the terms of the Asset-Backed Notes, the Company is required to maintain a reserve cash balance, funded through principal collections from the underlying securitized debt portfolio, which may be used to make monthly interest and principal payments on the Asset-Backed Notes. The Company has segregated these funds and classified them as restricted investments in money market funds on the Consolidated Statement of Assets and Liabilities. There was \$3.6 million of restricted investments in money market funds as of September 30, 2013.

#### **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 statement of assets and liabilities. 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 \$7.3 million and \$24.6 million as of September 30, 2013 and December 31, 2012, respectively. Commitments to extend credit consist principally of the unused portions of commitments that obligate the Company to extend credit, such as revolving credit arrangements or similar transactions. Commitments may also include a financial or non-financial milestone that has to be achieved before the commitment can be drawn. Commitments generally have fixed expiration dates or other termination clauses. Since commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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

The Company's debt investments consist primarily of loans to development-stage companies at various stages of development in the technology, life science, healthcare information and services and cleantech industries. Many of these companies may have relatively limited operating histories and also may experience variation in operating results. Many of these companies conduct business in regulated industries and could be affected by changes in

government regulations. Most of the Company's borrowers will need additional capital to satisfy their continuing working capital needs and other requirements, and in many instances, to service the interest and principal payments on the loans.

The largest loans may vary from year to year as new loans are recorded and repaid. The Company's five largest loans represented 21% and 23% of total loans outstanding as of September 30, 2013 and December 31, 2012, respectively. No single loan represents more than 10% of the total loans as of September 30, 2013 and December 31, 2012. Loan income, consisting of interest and fees, can fluctuate significantly upon repayment of large loans. Interest income from the five largest loans accounted for 21% and 23% of total interest income on investments for the three months ended September 30, 2013 and 2012, respectively. Interest income from the five largest loans accounted for 22% and 23% of total interest income on investments for the nine months ended September 30, 2013 and 2012, respectively.

**Horizon Technology Finance Corporation and Subsidiaries****Notes to Consolidated Financial Statements****(In thousands, except shares and per share data)****Note 9. 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 since inception:

| Date Declared                        | Record Date | Payment Date | Amount Per Share | Cash Distribution | DRIP Shares Issued | DRIP Share Value |
|--------------------------------------|-------------|--------------|------------------|-------------------|--------------------|------------------|
| Nine Months Ended September 30, 2013 |             |              |                  |                   |                    |                  |
| 8/2/13                               | 11/19/13    | 12/16/13     | \$ 0.115         | \$ —              | —                  | \$ —             |
| 8/2/13                               | 10/17/13    | 11/15/13     | \$ 0.115         | \$ —              | —                  | \$ —             |
| 8/2/13                               | 9/18/13     | 10/15/13     | \$ 0.115         | \$ 1,051          | 3,882              | \$ 52            |
| 5/3/13                               | 8/19/13     | 9/16/13      | \$ 0.115         | \$ 1,057          | 3,376              | \$ 46            |
| 5/3/13                               | 7/17/13     | 8/15/13      | \$ 0.115         | \$ 1,060          | 2,980              | \$ 42            |
| 5/3/13                               | 6/20/13     | 7/15/13      | \$ 0.115         | \$ 1,070          | 2,191              | \$ 31            |
| 3/8/13                               | 5/20/13     | 6/17/13      | \$ 0.115         | \$ 1,086          | 1,099              | \$ 15            |
| 3/8/13                               | 4/18/13     | 5/15/13      | \$ 0.115         | \$ 1,087          | 1,035              | \$ 15            |
| 3/8/13                               | 3/20/13     | 4/15/13      | \$ 0.115         | \$ 1,046          | 3,867              | \$ 55            |
|                                      |             |              | \$ 1.035         | \$ 7,457          | 18,430             | \$ 256           |
| Year Ended December 31, 2012         |             |              |                  |                   |                    |                  |
| 11/27/12                             | 2/21/13     | 3/15/13      | \$ 0.115         | \$ 1,050          | 3,392              | \$ 50            |
| 11/27/12                             | 1/18/13     | 2/15/13      | \$ 0.115         | \$ 1,087          | 898                | \$ 14            |
| 11/27/12                             | 12/20/12    | 1/15/13      | \$ 0.115         | \$ 1,056          | 2,930              | \$ 44            |
| 11/2/12                              | 11/16/12    | 11/30/12     | \$ 0.450         | \$ 4,243          | 4,269              | \$ 61            |
| 8/7/12                               | 8/17/12     | 8/31/12      | \$ 0.450         | \$ 4,105          | 11,608             | \$ 193           |
| 5/3/12                               | 5/17/12     | 5/31/12      | \$ 0.450         | \$ 3,402          | 2,299              | \$ 37            |
| 3/12/12                              | 3/23/12     | 3/30/12      | \$ 0.450         | \$ 3,378          | 3,517              | \$ 58            |
|                                      |             |              | \$ 2.145         | \$ 18,321         | 28,913             | \$ 457           |
| Year Ended December 31, 2011         |             |              |                  |                   |                    |                  |
| 11/8/11                              | 11/23/11    | 11/30/11     | \$ 0.450         | \$ 3,281          | 9,814              | \$ 151           |
| 8/9/11                               | 8/23/11     | 8/30/11      | \$ 0.400         | \$ 2,836          | 13,193             | \$ 209           |
| 5/10/11                              | 5/19/11     | 5/26/11      | \$ 0.330         | \$ 2,190          | 20,104             | \$ 316           |
|                                      |             |              | \$ 1.180         | \$ 8,307          | 43,111             | \$ 676           |



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On November 1, 2013, the Board declared monthly dividends payable as set forth in the table below.

| Record Dates      | Payment Date      | Dividends<br>Declared |
|-------------------|-------------------|-----------------------|
| February 17, 2014 | March 17, 2014    | \$ 0.115              |
| January 20, 2014  | February 17, 2014 | \$ 0.115              |
| December 16, 2013 | January 15, 2014  | \$ 0.115              |

**Horizon Technology Finance Corporation and Subsidiaries****Notes to Consolidated Financial Statements****(In thousands, except shares and per share data)****Note 10. Subsequent Events**

On November 4, 2013 the Company renewed and amended its Wells Facility previously administered by Wells and facilitated the assignment of all rights and obligations of Wells under the Wells Facility to Key Equipment Finance, Inc. (“Key”) (hereinafter in this footnote the Wells Facility shall be referred to as the “Key Facility”).

The Key Facility, among other things, provides the Company’s wholly owned subsidiary, Credit II, with a \$50 million commitment from Key and contains an “accordion” feature allowing additional lenders to make commitments under the Key Facility up to an aggregate commitment of \$150 million. The Key Facility has a three year revolving period followed by a two year amortization period and matures on November 4, 2018. The Key Facility generally bears interest based on LIBOR plus 3.25%, with a LIBOR floor of 0.75%. The Key Facility allows for a maximum advance rate of 50% against eligible loans and will be secured by all of the assets of Credit II. The Company has made certain customary representations and warranties, and is required to comply with various covenants, reporting requirements and other customary requirements for similar credit facilities.

**Note 11. Financial Highlights**

The financial highlights for the Company are as follows:

|   | Nine Months Ended September 30, |          |
|---|---------------------------------|----------|
|   | 2013                            | 2012     |
| Per share data:                                       |                                 |          |
| Net asset value at beginning of period                | \$ 15.15                        | \$ 17.01 |
| Net investment income                                 | 1.03                            | 1.06     |
| Realized loss on investments                          | (0.61                           | (0.01    |
|   | )                               | )        |
| Unrealized appreciation (depreciation) on investments | 0.42                            | (0.02    |
|   |                                 | )        |
| Net increase in net assets resulting from operations  | 0.84                            | 1.03     |

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|  |            |       |            |      |
|--|------------|-------|------------|------|
| Net dilution from issuance of common stock | —          |       | (0.28      | )    |
| Dividends declared                         | (1.04      | )     | (1.35      | )    |
| Net asset value at end of period           | \$ 14.95   |       | \$ 16.41   |      |
| Per share market value, end of period      | \$ 13.32   |       | \$ 16.16   |      |
| Total return based on a market value       | (3.8       | )%(1) | 7.3        | %(1) |
| Shares outstanding at end of period        | 9,588,993  |       | 9,562,956  |      |
| Ratios to average net assets:              |            |       |            |      |
| Expenses without incentive fees            | 11.5       | %(2)  | 8.0        | %(2) |
| Incentive fees                             | 2.3        | %(2)  | 2.0        | %(2) |
| Total expenses                             | 13.8       | %(2)  | 10.0       | %(2) |
| Provision for excise tax                   | 0.2        | %(2)  | —          | %(2) |
| Net investment income with incentive fees  | 9.1        | %(2)  | 8.4        | %(2) |
| Average net asset value                    | \$ 143,951 |       | \$ 135,934 |      |
| Average debt per share                     | 11.56      |       | 7.37       |      |
| Portfolio turnover ratio                   | 29.3       | %     | 48.3       | %    |

The total return for the nine months ended September 30, 2013 and 2012, equals the change in the ending market (1) value over the beginning of period price per share plus dividends paid per share during the period, divided by the beginning price.

(2)

Annualized.

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

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

### 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 investment advisor, Horizon Technology Management LLC, or the 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;

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- our business prospects and the prospects of our portfolio companies;
- the impact, extent and timing of technological changes and the adequacy of intellectual property protection;
  - our regulatory structure and tax status;
  - the adequacy of our cash resources and working capital;
- the timing of cash flows, if any, from the operations of our portfolio companies;
- the impact of interest rate volatility on our results, particularly if we use leverage as part of our investment strategy;
  - the ability of our portfolio companies to achieve their objective;
- our ability to cause a subsidiary to become a licensed Small Business Investment Company;
- the impact of legislative and regulatory actions and reforms and regulatory supervisory or enforcement actions of government agencies relating to us or our Advisor;
  - our contractual arrangements and relationships with third parties;
  - our ability to access capital and any future financings by us;
  - the ability of our Advisor to attract and retain highly talented professionals; and
  - the impact of changes to tax legislation and, generally, our tax position.

We use words such as “anticipates,” “believes,” “expects,” “intends,” “seeks” and similar expressions to identify forward-looking statements. Undue influence should not be placed on the forward looking statements as our actual results could differ materially from those projected in the forward-looking statements for any reason, including the factors set forth as “Risk Factors” in our annual report on Form 10-K for the year ended December 31, 2012, 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 U.S. Securities and Exchange Commission, or the SEC, including, periodic reports on Form 10-Q and Form 10-K and current reports on Form 8-K.

## Overview

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

We are an externally managed, closed-end, non-diversified management investment company that has elected to be regulated as a business development company, or BDC, under the Investment Company Act of 1940, as amended, or the 1940 Act. In addition, for U.S. federal income tax purposes, we have elected to be treated as a regulated investment company, or RIC, under Subchapter M of the Internal Revenue Code of 1986, as amended, or the Code. As a BDC, we are required to comply with regulatory requirements, including limitations on our use of debt. We are permitted to, and expect to, finance our investments through borrowings. However, as a BDC, we are only generally allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. The amount of leverage that we employ depends on our assessment of market conditions and other factors at the time of any proposed borrowing.

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

Our investment activities are managed by the Advisor and supervised by our board of directors, or the Board, of which a majority of the members are independent of us. Under an investment management agreement, or the Investment Management Agreement, we have agreed to pay the Advisor a base management fee and an incentive fee for its advisory services to us. We have also entered into an administration agreement, or the Administration Agreement, with the Advisor under which we have agreed to reimburse the Advisor for our allocable portion of overhead and other expenses incurred by the Advisor in performing its obligations under the Administration Agreement.

**Portfolio Composition and Investment Activity**

The following table shows our portfolio by asset class as of September 30, 2013 and December 31, 2012:

|                   | September 30, 2013 |            |                               | December 31, 2012 |            |                               |   |
|-------------------|--------------------|------------|-------------------------------|-------------------|------------|-------------------------------|---|
|                   | # of Investments   | Fair Value | Percentage of Total Portfolio | # of Investments  | Fair Value | Percentage of Total Portfolio |   |
| Term loans        | 48                 | \$216,569  | 89.7                          | % 41              | \$200,685  | 87.8                          | % |
| Revolving loans   | 2                  | 15,092     | 6.3                           | % 4               | 19,612     | 8.6                           | % |
| Total loans       | 50                 | 231,661    | 96.0                          | % 45              | 220,297    | 96.4                          | % |
| Warrants          | 71                 | 6,611      | 2.7                           | % 62              | 5,468      | 2.4                           | % |
| Other investments | 1                  | 2,000      | 0.8                           | % 1               | 2,100      | 0.9                           | % |
| Equity            | 4                  | 1,047      | 0.5                           | % 2               | 748        | 0.3                           | % |
| Total             |                    | \$241,319  | 100.0                         | %                 | \$228,613  | 100.0                         | % |

Total portfolio investment activity as of and for the periods ended September 30, 2013 and 2012 was as follows:

|  | For the Three Months Ended |            | For the Nine Months Ended |            |
|--|----------------------------|------------|---------------------------|------------|
|  | September 30,              |            | September 30,             |            |
|  | 2013                       | 2012       | 2013                      | 2012       |
| Beginning portfolio                            | \$ 246,861                 | \$ 195,600 | \$ 228,613                | \$ 178,013 |
| New loan funding                               | 11,500                     | 48,464     | 69,143                    | 117,459    |
| Less refinanced balances and participation     | —                          | (12,000 )  | —                         | (30,739 )  |
| Net new loan funding                           | 11,500                     | 36,464     | 69,143                    | 86,720     |
| Principal payments received on investments     | (10,536 )                  | (10,607 )  | (29,193 )                 | (28,522 )  |
| Early pay-offs                                 | (7,483 )                   | (1,459 )   | (26,761 )                 | (15,664 )  |
| Accretion of loan fees                         | 694                        | 606        | 1,995                     | 1,698      |
| New loan fees                                  | (118 )                     | (372 )     | (806 )                    | (1,120 )   |
| New equity                                     | —                          | —          | 73                        | —          |
| Proceeds from sale of investments              | —                          | —          | (39 )                     | (38 )      |
| Net realized loss on investments               | (5,566 )                   | —          | (5,629 )                  | (61 )      |
| Net appreciation (depreciation) on investments | 5,967                      | 677        | 3,996                     | (117 )     |
| Other  | —                          | —          | (73 )                     | —          |
| Ending Portfolio                               | \$ 241,319                 | \$ 220,909 | \$ 241,319                | \$ 220,909 |

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 loan portfolio by industry sector as of September 30, 2013 and December 31, 2012:

|                    | September 30, 2013  |                               | December 31, 2012   |                               |   |  |
|--------------------|---------------------|-------------------------------|---------------------|-------------------------------|---|--|
|                    | Loans at Fair Value | Percentage of Total Portfolio | Loans at Fair Value | Percentage of Total Portfolio |   |  |
| Life Science       |                     |                               |                     |                               |   |  |
| Biotechnology      | \$ 12,618           | 9.8                           | % \$ 38,018         | 17.3                          | % |  |
| Medical Device     | 19,423              | 8.4                           | % 23,446            | 10.6                          | % |  |
| Technology         |                     |                               |                     |                               |   |  |
| Software           | 71,953              | 31.0                          | % 54,358            | 24.7                          | % |  |
| Internet and Media | 6,579               | 2.8                           | % 9,763             | 4.4                           | % |  |
| Communication      | 6,296               | 2.7                           | % —                 | —                             | % |  |
| Semiconductors     | 36,106              | 15.6                          | % 25,795            | 11.7                          | % |  |
| Power Management   | 14,289              | 6.2                           | % 15,792            | 7.2                           | % |  |
| Cleantech          |                     |                               |                     |                               |   |  |
| Energy Efficiency  | 14,153              | 6.1                           | % 12,950            | 5.9                           | % |  |



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|                                     |            |       |   |            |       |   |
|-------------------------------------|------------|-------|---|------------|-------|---|
| Waste Recycling                     | 1,629      | 0.7   | % | 2,197      | 1.0   | % |
| Alternative Energy                  | 12,841     | 5.5   | % | 8,586      | 3.9   | % |
| Healthcare Information and Services |            |       |   |            |       |   |
| Diagnostics                         | 14,809     | 6.4   | % | 21,340     | 9.7   | % |
| Other Healthcare Related Services   | 6,894      | 3.0   | % | 2,655      | 1.2   | % |
| Software                            | 4,071      | 1.8   | % | 5,397      | 2.4   | % |
| Total                               | \$ 231,661 | 100.0 | % | \$ 220,297 | 100.0 | % |

The largest loans may vary from year to year as new loans are recorded and repaid. Our five largest loans represented 21% and 23% of total loans outstanding as of September 30, 2013 and December 31, 2012, respectively. No single loan represented more than 10% of our total loans as of September 30, 2013 and December 31, 2012.

## Loan Portfolio Asset Quality

We use an internal 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 represents an increased level of risk and while no loss is currently anticipated for a 2 rated loan, there is potential for future loss of principal. A rating of 1 represents a deteriorating credit quality and increased risk. Our internal credit rating system is not a national credit rating system. The following table shows the classification of our loan portfolio by credit rating as of September 30, 2013 and December 31, 2012:

| Credit Rating | September 30, 2013  |                              | December 31, 2012   |                              |   |  |
|---------------|---------------------|------------------------------|---------------------|------------------------------|---|--|
|               | Loans at Fair Value | Percentage of Loan Portfolio | Loans at Fair Value | Percentage of Loan Portfolio |   |  |
| 4             | \$38,909            | 16.8                         | % \$30,818          | 14.0                         | % |  |
| 3             | 170,768             | 73.7                         | % 181,019           | 82.2                         | % |  |
| 2             | 14,880              | 6.4                          | % 3,560             | 1.6                          | % |  |
| 1             | 7,104               | 3.1                          | % 4,900             | 2.2                          | % |  |
| Total         | \$231,661           | 100.0                        | % \$220,297         | 100.0                        | % |  |

As of September 30, 2013 and December 31, 2012, our loan portfolio had a weighted average credit rating of 3.1 and 3.2, respectively. As of September 30, 2013, there were three investments with a credit rating of 2. As of December 31, 2012, there was one investment with a credit rating of 2. As of both September 30, 2013 and December 31, 2012, there were three investments with a credit rating of 1, all of which were on non-accrual status.

## Consolidated Results of Operations

As a BDC and a RIC for U.S. federal income tax purposes, we are subject to certain constraints on our operations, including limitations imposed by the 1940 Act and the Code. 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, 2013 and 2012 are as follows:

|  | For the Three<br>Months Ended<br>September 30, |           |
|--|--|-----------|
|  | 2013   | 2012      |
| Total investment income                              | \$8,712  | \$6,619   |
| Total expenses                                       | 5,145  | 3,650     |
| Net investment income before excise tax              | 3,567  | 2,969     |
| Provision for excise tax                             | (80 )  | —         |
| Net investment income                                | 3,487  | 2,969     |
| Net realized loss on investments                     | (5,566 )                                       | —         |
| Net unrealized appreciation on investments           | 5,967  | 677       |
| Net increase in net assets resulting from operations | \$3,888  | \$3,646   |
| Average investments, at fair value                   | \$238,167                                      | \$195,147 |
| Average debt outstanding                             | \$133,000                                      | \$59,112  |

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

*Comparison of the three months ended September 30, 2013 and 2012*

***Investment Income***

Investment income increased by \$2.1 million, or 31.6%, for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012. For the three months ended September 30, 2013, total investment income consisted primarily of \$8.2 million in interest income from investments, which included \$1.6 million in income from the accretion of origination fees and end-of-term payments, or ETPs. Interest income on investments and other investment income increased primarily due to the increased average size of the loan portfolio and higher fee income. Fee income, for the three months ended September 31, 2013, of \$0.5 million was primarily earned from prepayment fees collected from our portfolio companies, as we experienced early payoffs of \$7.5 million. For the three months ended September 30, 2012, total investment income consisted primarily of \$6.4 million in interest income from investments, which included \$1.1 million in income from the accretion of origination fees and ETPs.

For the three months ended September 30, 2013 and 2012, our dollar-weighted average annualized yield on average debt investments was 14.6% and 13.6%, respectively. We calculate the yield on dollar-weighted average debt investments for any period measured as (1) total investment income during the period divided by (2) the average of the fair value of debt investments outstanding on (a) the last day of the calendar month immediately preceding the first day of the period and (b) the last day of each calendar month during the period.

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 21% and 23% of investment income for the three months ended September 30, 2013 and 2012, respectively.

As of September 30, 2013 and December 31, 2012, interest receivables were \$4.1 million and \$2.8 million, respectively, which represent accreted ETPs and one month of accrued interest income on substantially all of our loans.

### *Expenses*

Total expenses increased by \$1.5 million, or 41.0%, to \$5.1 million for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012. 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 for the three months ended September 30, 2013 and 2012 was \$2.2 million and \$1.1 million, respectively. Interest expense for the three months ended September 30, 2013 increased primarily due to an increase in our average debt outstanding, as well as an increase in borrowing cost associated with our term loan credit facility.

Management fee expense for the three months ended September 30, 2013 and 2012 was \$1.3 million and \$1.1 million, respectively. Management fee expense increased compared to the three months ended September 30, 2012 as a result of an increase in average gross assets partially offset by a waiver of the base management fee earned on cash during the period. The Advisor waived \$0.1 million of the base management fees it would have otherwise earned during the three months ended September 30, 2013. The Advisor waived such fees because we held more cash during the three month period than is typical for us to hold during a three month period. We held such cash due to the sale of the Asset-Backed Notes on June 28, 2013. Our Advisor is not obligated to waive the base management fee on cash in future periods.

Performance based incentive fee for the three months ended September 30, 2013 increased compared to the three months ended September 30, 2012 due to higher pre-incentive fee net investment income in the three months ended September 30, 2013. The incentive fees for the three months ended September 30, 2013 and 2012 were \$0.9 million and \$0.7 million, respectively, and consisted entirely of incentive fees payable on pre-incentive fee net investment income. Administrative fee expense for the three months ended September 30, 2013 and 2012 was \$0.3 million and \$0.4 million, respectively.

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

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

During the three months ended September 30, 2013, we recognized realized losses totaling \$5.6 million primarily due to the determination that our non-accrual debt investment and warrant investments in one portfolio company were not recoverable, which resulted in a realized loss totaling \$5.3 million. During the three months ended September 30, 2012, we did not have any recognized realized gains or losses.

During the three months ended September 30, 2013, net unrealized appreciation on investments totaled \$6.0 million which was primarily due to the reversal of previously recorded unrealized depreciation on our non-accrual debt investment and warrant investments in one portfolio company totaling \$5.3 million and the remainder related to the change in fair values of our investment portfolio during the period. During the three months ended September 30, 2012, net unrealized appreciation on investments totaled \$0.7 million which was primarily due to the change in fair values of our investment portfolio during the period.

Consolidated operating results for the nine months ended September 30, 2013 and 2012 are as follows:

|   | For the Nine Months<br>Ended<br>September 30, |           |
|---|---|-----------|
|   | 2013  | 2012      |
| Total investment income                                   | \$24,868                                      | \$18,726  |
| Total expenses  | 14,846  | 10,146    |
| Net investment income before excise tax                   | 10,022  | 8,580     |
| Provision for excise tax                                  | (160 )  | —         |
| Net investment income                                     | 9,862   | 8,580     |
| Net realized loss on investments                          | (5,839 )                                      | (61 )     |
| Net unrealized appreciation (depreciation) on investments | 3,996   | (117 )    |
| Net increase in net assets resulting from operations      | \$8,019                                       | \$8,402   |
| Average investments, at fair value                        | \$235,745                                     | \$179,417 |
| Average debt outstanding                                  | \$110,692                                     | \$59,886  |

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

*Comparison of the nine months ended September 30, 2013 and 2012*

### ***Investment Income***

Investment income increased by \$6.1 million, or 32.8%, for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012. For the nine months ended September 30, 2013, total investment income consisted primarily of \$24.0 million in interest income from investments, which included \$4.6 million in income from the accretion of origination fees and ETPs. Interest income on investments increased primarily due to the increased average size of the loan portfolio. Fee income for the nine months ended September 31, 2013 of \$0.9 million was primarily earned from prepayment fees collected from our portfolio companies as we experienced early payoffs of \$26.8 million. For the nine months ended September 30, 2012, total investment income consisted primarily of \$17.8 million in interest income from investments, which included \$3.1 million in income from the accretion of origination fees and ETPs.

For the nine months ended September 30, 2013 and 2012, our dollar-weighted average annualized yield on average debt investments was 14.1% and 13.9%, respectively. We calculate the yield on dollar-weighted average debt investments for any period measured as (1) total investment income during the period divided by (2) the average of the fair value of debt investments outstanding on (a) the last day of the calendar month immediately preceding the first day of the period and (b) the last day of each calendar month during the period.

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 22% and 23% of investment income for the nine months ended September 30, 2013 and 2012, respectively.

### ***Expenses***

Total expenses increased by \$4.7 million, or 46.3%, to \$14.8 million for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012. 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 for the nine months ended September 30, 2013 and 2012 was \$5.9 million and \$2.8 million, respectively. Interest expense for the nine months ended September 30, 2013 increased primarily due to an increase in our average debt outstanding, as well as an increase in borrowing cost associated with our term loan credit facility and our 2019 Notes.

Management fee expense for the nine months ended September 30, 2013 and 2012 was \$3.8 million and \$3.0 million, respectively. Management fee expense increased compared to the nine months ended September 30, 2012 as a result of an increase in average gross assets.

Performance based incentive fees for the nine months ended September 30, 2013 increased compared to the nine months ended September 30, 2012 due to higher pre-incentive fee net investment income in the nine months ended September 30, 2013. The incentive fees for the nine months ended September 30, 2013 and 2012 were \$2.5 million and \$2.0 million, respectively, and consisted entirely of incentive fees payable on pre-incentive fee net investment income. Administrative fee expense for both the nine months ended September 30, 2013 and 2012 was \$0.9 million.

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

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

During the nine months ended September 30, 2013, we recognized realized losses totaling \$5.8 million primarily due to the determination that our non-accrual debt investment and warrant investments in one portfolio company were not recoverable, which resulted in a realized loss totaling \$5.3 million. During the nine months ended September 30,



2012, we recognized realized losses of \$0.1 million primarily due to the charge off of warrants in one portfolio company.

During the nine months ended September 30, 2013, net unrealized appreciation on investments totaled \$4.0 million which was primarily due to the reversal of previously recorded unrealized depreciation on our non-accrual debt investment and warrant investments in one portfolio company totaling \$5.3 million and the remainder relates to change in fair values of our investment portfolio during the period. During the nine months ended September 30, 2012, net unrealized depreciation on investments totaled \$0.1 million which was primarily due to the change in fair values of our investment portfolio during the period.

### **Liquidity and Capital Resources**

As of September 30, 2013 and December 31, 2012, we had cash and investments in money market funds of \$31.0 million and \$3.6 million, respectively. As of September 30, 2013 and December 31, 2012, we had availability under our existing Credit Facilities of \$10.0 million and \$56.0 million, respectively. These amounts are available to fund new investments, reduce borrowings under a revolving credit facility with Wells Fargo Capital Finance, LLC, or the Wells Facility, and a term loan credit facility with Fortress Credit Co LLC, or the Fortress Facility, pay down the \$90 million principal amount of fixed-rate asset-backed notes, or Asset-Backed Notes, pay operating expenses and pay dividends. In this quarterly report on Form 10-Q, we refer to the Wells Facility and the Fortress Facility, collectively, as the Credit Facilities. Our primary sources of capital have been from our private and public common stock offerings, use of our Credit Facilities and issuance of our Asset-Backed Notes and 7.375% senior unsecured notes due in 2019, or the 2019 Notes.

As of September 30, 2013, there was no outstanding principal balance under the Wells Facility. As of September 30, 2013, we had available borrowing capacity of \$75.0 million under our Wells Facility, subject to existing terms and advance rates.

As of September 30, 2013, the outstanding principal balance under the Fortress Facility was \$10.0 million. As of September 30, 2013, we had available borrowing capacity of \$65.0 million under our Fortress Facility, subject to existing terms and advance rates.

Our operating activities used cash of \$30.9 million for the nine months ended September 30, 2013, and our financing activities provided cash of \$32.3 million for the same period. Our operating activities used cash primarily for investing in portfolio companies, net of principal payments received. Our financing activities provided cash primarily from the issuance of our Asset-Backed Notes, offset by a net decrease in borrowings under our Credit Facilities and our dividends paid in the period.

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

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

At September 30, 2013, we had \$3.6 million of restricted investments in money market funds. Our restricted investments in money market funds are generated from collections of principal payments on assets that secure the Asset-Backed Notes. In accordance with the terms of the related securitized Asset-Backed Notes, the restricted funds may be used to pay monthly fees, interest and principal on the Asset-Backed Notes and are not distributed to us or available for our general operations.

In order to satisfy the Code requirements applicable to a RIC, we distribute to our stockholders all or substantially all of our income except for certain net capital gains. In addition, as a BDC, we are required to meet a coverage ratio of 200%. This requirement limits the amount that we may borrow. As of September 30, 2013, the asset coverage for borrowed amounts was 208%.

We believe that our current cash and investments in money market funds, cash generated from operations, and funds available from our Credit Facilities will be sufficient to meet our working capital and capital expenditure commitments for at least the next 12 months.

***Current Borrowings***

A summary of our borrowings as of September 30, 2013 and December 31, 2012 is as follows:

|                    | September 30, 2013 |             |            |
|--------------------|--------------------|-------------|------------|
|                    | Total              | Balance     | Unused     |
|                    | Commitment         | Outstanding | Commitment |
| Asset-Backed Notes | \$90,000           | \$ 90,000   | \$ —       |
| Wells Facility     | 75,000             | —           | 75,000     |
| Fortress Facility  | 75,000             | 10,000      | 65,000     |
| 2019 Notes         | 33,000             | 33,000      | —          |
| Total              | \$273,000          | \$ 133,000  | \$ 140,000 |

|                   | December 31, 2012 |             |            |
|-------------------|-------------------|-------------|------------|
|                   | Total             | Balance     | Unused     |
|                   | Commitment        | Outstanding | Commitment |
| Wells Facility    | \$75,000          | \$ 46,020   | \$ 28,980  |
| Fortress Facility | 75,000            | 10,000      | 65,000     |
| 2019 Notes        | 33,000            | 33,000      | —          |
| Total             | \$183,000         | \$ 89,020   | \$ 93,980  |

We, through our wholly owned subsidiary, Horizon Credit II LLC, or Credit II, entered into the Wells Facility on July 14, 2011. The interest rate was based upon the one-month LIBOR plus a spread of 4.00%, with a LIBOR floor of 1.00%. On May 28, 2013, we entered into an agreement with Wells Fargo Capital Finance, LLC to amend the Wells Facility. As amended, effective May 1, 2013, the stated interest rate of the Wells Facility was reduced to the one-month LIBOR plus a spread of 3.25%, with a LIBOR floor of 1.00%. In general, all other terms and conditions of the Wells Facility remain unchanged. The interest rate was 4.25% and 5.00% as of September 30, 2013 and December 31, 2012, respectively.

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

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

On March 23, 2012, we issued and sold \$30 million aggregate principal amount of 2019 Notes, and on April 18, 2012, pursuant to the underwriters' 30 day option to purchase additional notes, we sold an additional \$3 million of such notes. The 2019 Notes will mature on March 15, 2019 and may be redeemed in whole or in part at our option at any time or from time to time on or after March 15, 2015 at a redemption price of \$25 per security plus accrued and unpaid interest. The 2019 Notes bear interest at a rate of 7.375% per year payable quarterly on March 15, June 15, September 15 and December 15 of each year. The 2019 Notes are our direct, unsecured obligations and rank (1) equally in right of payment with our future senior unsecured indebtedness; (2) senior in right of payment to any of our future indebtedness that expressly provides it is subordinated to the 2019 Notes; (3) effectively subordinated to all of our existing and future secured indebtedness (including indebtedness that is initially unsecured to which we subsequently grant security), to the extent of the value of the assets securing such indebtedness and (4) structurally subordinated to all existing and future indebtedness and other obligations of any of our subsidiaries. As of September 30, 2013, we were in material compliance with the terms of the 2019 Notes. The 2019 Notes are listed on the New York Stock Exchange under the symbol "HTF".

We, through our wholly owned subsidiary Horizon Credit III LLC, or Credit III, entered into the Fortress Facility on August 23, 2012. The interest rate on the Fortress Facility is based upon the one-month LIBOR plus a spread of 6.00%, with a LIBOR floor of 1.00%. The interest rate was 7.00% as of September 30, 2013 and December 31, 2012.

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

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

On June 28, 2013, we completed a \$189.3 million securitization of secured loans which we originated. Horizon Funding Trust 2013-1, or 2013-1 Trust, a newly formed wholly owned subsidiary of ours, issued the Asset-Backed Notes, which are rated A2(sf) by Moody's Investors Service, Inc. We are the sponsor, originator and servicer for the transaction. The Asset-Backed Notes bear interest at a fixed rate of 3.00% per annum and have a stated maturity of May 15, 2018.

The Asset-Backed Notes were issued by 2013-1 Trust pursuant to a Note Purchase Agreement, dated as of June 28, 2013, by and among us, Horizon Funding 2013-1 LLC, or 2013-1 LLC, as trust depositor, 2013-1 Trust and Guggenheim Securities, LLC, or Guggenheim Securities, as initial purchaser, and are backed by a pool of loans made to certain portfolio companies of ours and secured by certain assets of such portfolio companies. The pool of loans is to be serviced by us. In connection with the issuance and sale of the Asset-Backed Notes, we have made customary representations, warranties and covenants in the Note Purchase Agreement. The Asset-Backed Notes are secured obligations of 2013-1 Trust and are non-recourse to us.

As part of the transaction, we entered into a Sale and Contribution Agreement, dated as of June 28, 2013, with 2013-1 LLC, pursuant to which we have agreed to sell or have contributed to 2013-1 LLC, certain secured loans made to certain portfolio companies of ours, or the Loans. We have made customary representations, warranties and covenants in the Sale and Contribution Agreement with respect to the Loans as of the date of the transfer of the Loans to 2013-1 LLC. We have also entered into a sale and servicing agreement, dated as of June 28, 2013, with 2013-1 LLC and 2013-1 Trust pursuant to which 2013-1 LLC has agreed to sell or has contributed the Loans to 2013-1 Trust. We have made customary representations, warranties and covenants in the sale and servicing agreement. We will also serve as administrator to 2013-1 Trust pursuant to an administration agreement, dated as of June 28, 2013, with 2013-1 Trust, Wilmington Trust, National Association, and U.S. Bank National Association. 2013-1 Trust also entered into an indenture, dated as of June 28, 2013, which governs the Asset-Backed Notes and includes customary covenants and events of default. In addition, 2013-1 LLC entered into an amended and restated trust agreement, dated as of June 28, 2013, which includes customary representations, warranties and covenants. The Asset-Backed Notes were sold through an unregistered private placement to “qualified institutional buyers” in compliance with the exemption from registration provided by Rule 144A under the Securities Act of 1933 as amended, or the Securities Act, and to institutional “accredited investors” (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act) who, in each case, are “qualified purchasers” for purposes of Section 3(c)(7) under the 1940 Act.

On June 3, 2013, we entered into a Promissory Note with Guggenheim Securities, or the Promissory Note, whereby Guggenheim Securities made a term loan in the original principal amount of \$15 million, or the Term Loan, to us. We granted Guggenheim Securities a security interest in all of its assets to secure the Term Loan. On June 28, 2013, the Company used a portion of the proceeds of the private placement of the Asset-Backed Notes to repay all of its outstanding obligations under the Term Loan and the security interest of Guggenheim Securities was released.

As of September 30, 2013 and December 31, 2012, other assets were \$5.4 million and \$4.6 million, respectively, which were primarily, comprised of debt issuance costs.

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

A summary of our significant contractual payment obligations and off-balance sheet arrangements as of September 30, 2013 is as follows:

## Payments due by period

|                      | Total      | Less than 1 year | 1 – 3 Years | 3-5 Years | After 5 years |
|----------------------|------------|------------------|-------------|-----------|---------------|
| Borrowings           | \$ 133,000 | \$ 27,901        | \$ 70,702   | \$ 1,397  | \$ 33,000     |
| Unfunded commitments | 7,299      | 6,299            | 1,000       | —         | —             |
| Total                | \$ 140,299 | \$ 34,200        | \$ 71,702   | \$ 1,397  | \$ 33,000     |

In the normal course of business, we are party to financial instruments with off-balance sheet risk. These consist primarily of unfunded commitments to extend credit, in the form of loans, to our portfolio companies. Unfunded commitments to provide funds to portfolio companies are not reflected on our balance sheet. Our unfunded commitments may be significant from time to time. As of September 30, 2013, we had unfunded commitments of \$7.3 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 Fortress 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 gross assets and (2) a two-part incentive fee. We have also entered into a contract with our Advisor to serve as our administrator. Payments under the Administration Agreement are equal to an amount based upon our allocable portion of our Advisor's overhead in performing its obligation under the agreement, including rent, fees and other expenses inclusive of our allocable portion of the compensation of our Chief Financial Officer and Chief Compliance Officer and their respective staffs. See Note 3 to our Consolidated Financial Statements for additional information regarding our Investment Management Agreement and our Administration Agreement.

### ***Distributions***

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

### **Related Party Transactions**

We have entered into a number of business relationships with affiliated or related parties, including the following:



We entered into the Investment Management Agreement with our Advisor. Mr. Robert D. Pomeroy Jr., Chairman of the Board and our Chief Executive Officer, is a manager of the Advisor, and Mr. Gerald A. Michaud, our President and a Director, is a manager of our Advisor.

Our Advisor provides us with the office facilities and administrative services necessary to conduct day-to-day operations pursuant to our Administration Agreement.

- We have entered into a license agreement with the predecessor of the Advisor, pursuant to which it has granted us a non-exclusive, royalty-free license to use the name “Horizon Technology Finance.”

Our Advisor may manage other investment vehicles with the same investment strategy as us, which we refer to in this report as “Advisor Funds.” Our Advisor may provide us an opportunity to co-invest with the Advisor Funds. Under the 1940 Act, absent receipt of exemptive relief from the SEC, we and our affiliates may be precluded from co-investing in such investments. Accordingly, we may apply for exemptive relief which would permit us to co-invest subject to certain conditions, including approval of such investments by both a majority of our directors who have no financial interest in such transaction and a majority of directors who are not interested directors as defined in the 1940 Act.

## **Critical Accounting Policies**

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

We have identified the following items as critical accounting policies.

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

Investments are recorded at fair value. Our Board determines the fair value of our portfolio investments. We measure substantially all of our investments at fair value 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.

Our Board determines the fair value of our investments in good faith, based on the input of management, the audit committee and independent valuation firms that have been engaged at the direction of our Board to assist in the valuation of each portfolio investment without a readily available market quotation at least once during a trailing twelve-month period under our valuation policy and a consistently applied valuation process. The Board conducts this valuation process at the end of each fiscal quarter, with 25% (based on fair value) of our valuation of portfolio companies that do not have a readily available market quotations subject to review by an independent valuation firm.

### ***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 ETP, 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 of our lending arrangements, we receive warrants to purchase shares of stock from the borrower. We record the warrants as assets at estimated fair value on the grant date using the Black-Scholes valuation model. We consider the warrants loan fees and also record 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, we also measure the warrants 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 or losses from the disposition of the warrants or stock acquired from the exercise of warrants are recognized as realized gains or losses on warrants.

Realized gains or losses on the sale of investments, or upon the determination that an investment balance, or portion thereof, is not recoverable, are calculated using the specific identification method. We measure realized gains or losses by calculating the difference between the net proceeds from the repayment or sale and the amortized cost basis of the investment. Net change in unrealized appreciation or depreciation reflects the change in the fair values of our portfolio investments during the reporting period, including any reversal of previously recorded unrealized appreciation or depreciation, when gains or losses are realized.

### ***Income taxes***

We have elected to be treated as a RIC under subchapter M of the Code and operate in a manner so as to qualify for the tax treatment applicable to RICs. In order to qualify as a RIC, among other things, we are required to meet certain source of income and asset diversification requirements and we must timely distribute to our stockholders at least 90% of investment company taxable income, as defined by the Code, for each year. We, among other things, have made and intend to continue to make the requisite distributions to our stockholders, which will generally relieve us from U.S. federal income taxes.

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

We evaluate tax positions taken in the course of preparing our tax returns to determine whether the tax positions are “more-likely-than-not” to be sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold, or uncertain tax positions, would be recorded as a tax expense in the current year. It is our policy to recognize accrued interest and penalties related to uncertain tax benefits in income tax expense. We had no material uncertain tax positions at September 30, 2013 and December 31, 2012.

### **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. We adopted ASU 2011-04 in the quarter ended March 31, 2012.

### **Item 3. Quantitative And Qualitative Disclosures About Market Risk**

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

Assuming that the consolidated statement of assets and liabilities as of September 30, 2013 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 consolidated statement of assets and liabilities and other business developments that could affect net increase in net assets resulting from operations, or net income. Accordingly, no assurances can be given that actual results would not differ materially from the statement above.

While our Asset-Backed Notes and 2019 Notes bear interest at a fixed rate, our Credit Facilities have a floating interest rate provision based on a LIBOR index which resets daily, and we expect that any other credit facilities into which we enter in the future may have floating interest rate provisions. We have used hedging instruments in the past to protect us against interest rate fluctuations and we may use them in the future. Such instruments may include swaps, futures, options and forward contracts. While hedging activities may insulate us against adverse changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to the investments in our portfolio with fixed interest rates.

Because we currently fund, and expect to continue to fund, our investments with borrowings, our net income depends upon the difference between the rate at which we borrow funds and the rate at which we invest the funds borrowed. Accordingly, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net income. In periods of rising interest rates, our cost of funds would increase, which could reduce our net investment income.

### **Item 4. Controls and Procedures**

#### ***(a) Evaluation of Disclosure Controls and Procedures***

As of September 30, 2013, 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 Securities Exchange Act of 1934, as amended, or the Exchange Act). Based on that evaluation, our management, including our 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 controls 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 controls over financial reporting.

## **PART II**

### **Item 1: Legal Proceedings.**

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

### **Item 1A: Risk Factors.**

In addition to other information set forth in this report, you should carefully consider the “Risk Factors” discussed in our annual report on Form 10-K for the year ended December 31, 2012, 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, 2013 to the risk factors set forth in “Item 1A. Risk Factors” of our annual report on Form 10-K for the year ended December 31, 2012.

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

None.

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

None.

### **Item 4: Mine Safety Disclosures.**

Not applicable



**Item 5: Other Information.**

None.

**Item 6: Exhibits.**

**EXHIBIT INDEX**

| <b>Exhibit<br/>No.</b> | <b>Description</b>  |
|------------------------|---|
| 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

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**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 5, 2013 By: /s/ Robert D. Pomeroy, Jr.

Name: Robert D. Pomeroy, Jr.

Title: Chief Executive Officer and Chairman of  
the Board of Directors

Date: November 5, 2013 By: /s/ Christopher M. Mathieu

Name: Christopher M. Mathieu

Title: Chief Financial Officer