

[Table of Contents](#)

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

**FORM 10-Q**

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

For the quarter ended September 30, 2012

- 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: 814-00235

**Rand Capital Corporation**

(Exact Name of Registrant as specified in its Charter)

<p><b>New York</b> (State or Other Jurisdiction of Incorporation or organization)</p> <p><b>2200 Rand Building, Buffalo, NY</b> (Address of Principal executive offices)</p>	<p><b>16-0961359</b> (IRS Employer Identification No.)</p> <p><b>14203</b> (Zip Code)</p>
<p><b>(716) 853-0802</b> (Registrant's telephone number, including area code)</p>	

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

As of October 31, 2012 there were 6,613,784 shares of the registrant's common stock outstanding.

---

**Table of Contents**

**RAND CAPITAL CORPORATION  
TABLE OF CONTENTS FOR FORM 10-Q**

**PART I. – FINANCIAL INFORMATION**

<u>Item 1. Financial Statements and Supplementary Data</u>	3
<u>Condensed Consolidated Statements of Financial Position as of September 30, 2012 (Unaudited) and December 31, 2011</u>	3
<u>Condensed Consolidated Statements of Operations for the Three Months and Nine Months Ended September 30, 2012 and 2011 (Unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011 (Unaudited)</u>	5
<u>Condensed Consolidated Statements of Changes in Net Assets for the Three Months and Nine Months Ended September 30, 2012 and 2011 (Unaudited)</u>	6
<u>Condensed Consolidated Schedule of Portfolio Investments as of September 30, 2012 (Unaudited)</u>	7
<u>Notes to the Consolidated Financial Statements (Unaudited)</u>	10
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	22
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	28
<u>Item 4. Controls and Procedures</u>	29

**PART II – OTHER INFORMATION**

<u>Item 1. Legal Proceedings</u>	30
<u>Item 1A. Risk Factors</u>	30
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
<u>Item 3. Defaults upon Senior Securities</u>	30
<u>Item 4. Mine Safety Disclosures</u>	30
<u>Item 5. Other Information</u>	30
<u>Item 6. Exhibits</u>	31

[Table of Contents](#)

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements and Supplementary Data**

**RAND CAPITAL CORPORATION AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION  
As of September 30, 2012 and December 31, 2011**

	September 30, 2012 (Unaudited)	December 31, 2011
<b>ASSETS</b>		
Investments at fair value:		
Control investments (cost of \$1,877,754 and \$966,895, respectively)	\$ 8,377,754	\$ 7,466,896
Affiliate investments (cost of \$7,327,855 and \$6,083,260, respectively)	6,746,025	5,838,975
Non-Control/Non-affiliate investments (cost of \$6,945,954 and \$6,358,527, respectively)	<u>12,686,753</u>	<u>10,625,990</u>
Total investments, at fair value (cost of \$16,151,563 and \$13,408,682, respectively)	<u>27,810,532</u>	23,931,861
Cash and cash equivalents	<u>4,042,981</u>	4,517,985
Interest receivable (net of allowance of \$186,654 as of 9/30/12 and \$122,000 as of 12/31/11)	<u>59,826</u>	83,869
Prepaid income taxes	<u>653,144</u>	822,789
Other assets	<u>869,227</u>	1,975,453
Total assets	<u><u>\$33,435,710</u></u>	<u><u>\$31,331,957</u></u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (NET ASSETS)</b>		
<b>Liabilities:</b>		
Debentures guaranteed by the SBA	\$ 3,900,000	\$ 4,000,000
Deferred tax liability	<u>3,346,036</u>	2,683,639
Accounts payable and accrued expenses	<u>252,589</u>	249,197
Deferred revenue	<u>8,333</u>	—
Total liabilities	<u><u>7,506,958</u></u>	<u><u>6,932,836</u></u>
<b>Stockholders' equity (net assets):</b>		
Common stock, \$.10 par; shares authorized 10,000,000; shares issued 6,863,034; shares outstanding of 6,757,992 as of 9/30/12 and 6,818,934 as of 12/31/11	<u>686,304</u>	686,304
Capital in excess of par value	<u>10,581,789</u>	10,581,789
Accumulated net investment (loss)	<u>(961,936)</u>	(1,729,856)
Undistributed net realized gain on investments	<u>8,575,988</u>	8,317,397
Net unrealized appreciation on investments	<u>7,250,972</u>	6,590,693
Treasury stock, at cost; 105,042 shares as of 9/30/12 and 44,100 shares as of 12/31/11	<u>(204,365)</u>	(47,206)
Total stockholders' equity (net assets), (per share 9/30/12 - \$3.84, 12/31/11- \$3.58)	<u><u>25,928,752</u></u>	<u><u>24,399,121</u></u>
Total liabilities and stockholders' equity	<u><u>\$33,435,710</u></u>	<u><u>\$31,331,957</u></u>

See accompanying notes

[Table of Contents](#)

**RAND CAPITAL CORPORATION AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
For the Three Months and Nine Months Ended September 30, 2012 and 2011  
(Unaudited)**

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
<b>Investment income:</b>				
Interest from portfolio companies:				
Control investments	\$ 9,818	\$ 13,401	\$ 32,259	\$ 42,618
Affiliate investments	123,269	151,808	355,316	444,671
Non-Control/Non-Affiliate investments	22,957	5,000	38,824	62,556
Total interest from portfolio companies	156,044	170,209	426,399	549,845
Interest from other investments	1,845	8,828	6,483	26,909
Total interest from other investments	1,845	8,828	6,483	26,909
Dividend and other investment income:				
Control investments	1,246,825	174,356	1,560,606	174,356
Affiliate investments	44,030	79,944	178,186	150,500
Non-Control/Non-Affiliate investments	—	—	6,950	—
Total dividend and other investment income	1,290,855	254,300	1,745,742	324,856
Other income:				
Control investments	2,000	2,000	4,000	6,000
Affiliate investments	—	1,000	2,000	3,000
Non-Control/Non-Affiliate investments	668	4,100	668	5,680
Total other income	2,668	7,100	6,668	14,680
<b>Total investment income</b>	<b>1,451,412</b>	<b>440,437</b>	<b>2,185,292</b>	<b>916,290</b>
<b>Operating expenses:</b>				
Salaries	122,478	118,750	365,683	356,250
Bonus and profit sharing	—	—	144,000	—
Employee benefits	31,350	22,700	105,387	88,384
Directors' fees	12,750	12,750	82,500	65,250
Professional fees	30,793	45,519	113,250	122,323
Stockholders and office operating	24,046	27,104	99,848	101,703
Insurance	12,228	7,800	31,470	27,646
Corporate development	20,988	15,773	53,846	48,510
Other operating	3,500	2,070	10,402	12,264
	258,133	252,466	1,006,386	822,330
Interest on SBA obligations	20,681	184,080	131,012	479,199
Bad Debt Expense	64,654	—	64,654	—
Total expenses	343,468	436,546	1,202,052	1,301,529
<b>Investment gain (loss) before income taxes</b>	<b>1,107,944</b>	<b>3,891</b>	<b>983,240</b>	<b>(385,239)</b>
Income tax expense (benefit)	281,017	18,809	215,320	(119,478)
<b>Net investment gain (loss)</b>	<b>826,927</b>	<b>(14,918)</b>	<b>767,920</b>	<b>(265,761)</b>
<b>Realized gain (loss) on investments:</b>				
Affiliate investments	—	(1)	—	(2,074,131)
Non-Control/Non-Affiliate investments	379,612	—	415,097	—
Income tax expense (benefit)	144,087	—	156,507	(751,568)
Net realized gain (loss) on investments	235,525	(1)	258,590	(1,322,563)
<b>Net (decrease) increase in unrealized appreciation on investments:</b>				
Affiliate investments	(337,546)	—	(337,546)	2,022,631
Non-Control/Non-Affiliate investments	(3,501,050)	1,531,999	1,473,336	1,673,800
Change in unrealized appreciation before income taxes	(3,838,596)	1,531,999	1,135,790	3,696,431
Deferred income tax (benefit) expense	(1,378,868)	544,840	475,511	1,324,178
<b>Net (decrease) increase in unrealized appreciation</b>	<b>(2,459,728)</b>	<b>987,159</b>	<b>660,279</b>	<b>2,372,253</b>
<b>Net realized and unrealized (loss) gain on investments</b>	<b>(2,224,203)</b>	<b>987,158</b>	<b>918,869</b>	<b>1,049,690</b>
<b>Net (decrease) increase in net assets from operations</b>	<b>(\$ 1,397,276)</b>	<b>\$ 972,240</b>	<b>\$ 1,686,789</b>	<b>\$ 783,929</b>
Weighted average shares outstanding	6,808,607	6,818,934	6,812,457	6,818,934
Basic and diluted net increase (decrease) in net assets per share from operations	(\$ 0.21)	\$ 0.14	\$ 0.25	\$ 0.11

See accompanying notes

[Table of Contents](#)

**RAND CAPITAL CORPORATION AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Nine Months Ended September 30, 2012 and 2011  
(Unaudited)**

	Nine months ended September 30, 2012	Nine months ended September 30, 2011
<b>Cash flows from operating activities:</b>		
Net increase in net assets from operations	\$ 1,686,789	\$ 783,929
Adjustments to reconcile net increase in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	59,902	94,744
Original issue discount accretion	(15,988)	(37,000)
Change in interest receivable allowance	64,654	(36,245)
Increase in unrealized appreciation of investments	(1,135,790)	(3,696,431)
Deferred tax benefit	662,397	1,102,296
Realized (gain) loss on portfolio investments, net	(415,097)	2,074,131
Non-cash conversion of debenture interest	(84,655)	(72,285)
Changes in operating assets and liabilities:		
Increase in interest receivable	(40,611)	(231,331)
Decrease in other assets	1,119,074	418,500
Decrease (increase) in prepaid income taxes	169,645	(222,545)
Increase (decrease) in accounts payable and accrued expenses	3,392	(765,567)
Increase (decrease) in deferred revenue	8,333	(5,650)
Total adjustments	<u>395,256</u>	<u>(1,377,383)</u>
<b>Net cash provided by (used in) operating activities</b>	<b>2,082,045</b>	<b>(593,454)</b>
<b>Cash flows from investing activities:</b>		
Investments originated	(3,130,728)	(1,171,944)
Proceeds from sale of investments	823,669	—
Proceed from loan repayments	79,918	571,163
<b>Net cash used in investing activities</b>	<b>(2,227,141)</b>	<b>(600,781)</b>
<b>Cash flows from financing activities:</b>		
Repayment of SBA debentures	(3,100,000)	(6,000,000)
Proceeds from SBA debentures	3,000,000	—
Origination costs to SBA	(72,750)	—
Purchase of treasury shares	(157,158)	—
<b>Net cash used in financing activities</b>	<b>(329,908)</b>	<b>(6,000,000)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(475,004)</b>	<b>(7,194,235)</b>
<b>Cash and cash equivalents:</b>		
Beginning of period	<u>4,517,985</u>	<u>11,698,653</u>
End of period	<b><u>\$ 4,042,981</u></b>	<b><u>\$ 4,504,418</u></b>

See accompanying notes

[Table of Contents](#)

**RAND CAPITAL CORPORATION AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS  
For the Three Months and Nine Months Ended September 30, 2012 and 2011  
(Unaudited)**

	Three months ended September 30, <u>2012</u>	Three months ended September 30, <u>2011</u>	Nine months ended September 30, <u>2012</u>	Nine months ended September 30, <u>2011</u>
<b>Net assets at beginning of period</b>	<u>\$27,483,186</u>	<u>\$22,862,507</u>	<u>\$24,399,121</u>	<u>\$23,050,818</u>
Net investment gain (loss)	826,927	(14,918)	767,920	(265,761)
Net realized gain (loss) on sales and dispositions of investments	235,525	(1)	258,590	(1,322,563)
Net (decrease) increase in unrealized appreciation	<u>(2,459,728)</u>	<u>987,159</u>	<u>660,279</u>	<u>2,372,253</u>
Net (decrease) increase in net assets from operations	(1,397,276)	972,240	1,686,789	783,929
Purchase of treasury shares	(157,158)	—	(157,158)	—
(Decrease) increase in net assets	<u>(1,554,434)</u>	<u>972,240</u>	<u>1,529,631</u>	<u>783,929</u>
<b>Net assets at end of period</b>	<b><u>\$25,928,752</u></b>	<b><u>\$23,834,747</u></b>	<b><u>\$25,928,752</u></b>	<b><u>\$23,834,747</u></b>

See accompanying notes

[Table of Contents](#)

**RAND CAPITAL CORPORATION AND SUBSIDIARY  
CONDENSED CONSOLIDATED SCHEDULE OF PORTFOLIO INVESTMENTS  
September 30, 2012  
(Unaudited)**

(a) Company, Geographic Location, Business Description, (Industry) and Website	(b) Type of Investment	(b) Date Acquired	(c) Equity	Cost	(d)(f) Fair Value	Per Share of Rand
<b>Non-Control/Non-Affiliate Investments: (j)</b>						
<b>BinOptics Corporation (e)(g)</b> Ithaca, NY. Design and manufacture of semiconductor FP and DFB lasers. (Electronics Developer) <a href="http://www.binoptics.com">www.binoptics.com</a>	13,818,122 Series 2 preferred shares.	11/8/11	4%	\$ 1,190,569	\$ 1,190,569	\$ .18
<b>Liazon Corporation (e)(g)</b> Buffalo, NY. Private health benefits exchange. (Health Benefits Provider) <a href="http://www.liazon.com">www.liazon.com</a>	120,000 Series C-1 preferred shares. 546,667 Series C-2 preferred shares. 100,000 Series D preferred shares.	11/9/10	3%	1,133,199	2,108,331	.31
<b>Mezmeriz, Inc. (e)(g)</b> Ithaca, NY. Micro-electronic mechanical systems (MEMS) developer enabling efficient, wide-angle, Pico projectors to be embedded in mobile devices. (Electronics Developer) <a href="http://www.mezmeriz.com">www.mezmeriz.com</a>	141,125 Series A preferred shares. \$250,000 notes at 8% due December 31, 2012.	1/9/08	4%	371,509	371,509	.06
<b>Rheonix, Inc. (e)</b> Ithaca, NY. Developer of microfluidic testing devices including channels, pumps, reaction vessels, & diagnostic chambers, for testing of small volumes of chemicals and biological fluids. (Manufacturing) <a href="http://www.rheonix.com">www.rheonix.com</a>	9,676 common shares. <b>(g)</b> 1,081,539 Series A preferred shares. 50,593 common shares.	10/29/09	4%	1,208,728	1,344,728	.20
<b>Somerset Gas Transmission Company, LLC</b> Columbus, OH. Natural gas transportation company. (Oil and Gas) <a href="http://www.somersetgas.com">www.somersetgas.com</a>	26,5337 units.	7/10/02	3%	719,097	786,748	.12
<b>Synacor, Inc. NASDAQ: SYNC (d)(e)(g)(m)(n)</b> Buffalo, NY. Develops provisioning platforms for aggregation and delivery of content and services across multiple digital devices. (Software) <a href="http://www.synacor.com">www.synacor.com</a>	852,362 unrestricted common shares valued at \$7.58 per share. See subsequent event disclosure( <b>n</b> ).	11/18/02	4%	956,178	6,459,950	.96
<b>Ultra—Scan Corporation (e)</b> Amherst, NY. Biometrics application developer of ultrasonic fingerprint technology. (Electronics Hardware/Software) <a href="http://www.ultra-scan.com">www.ultra-scan.com</a>	536,596 common shares. 107,104 Series A-1 preferred shares. <b>(g)</b> 95,284 Series A-1 preferred shares.	12/11/92	2%	938,164	424,918	.06
<b>Other Non-Control/Non-Affiliate Investments</b>			<b>428,510</b>	<b>0</b>	<b>.00</b>	
<b>Subtotal Non-Control/Non-Affiliate Investments</b>			<b>\$6,945,954</b>	<b>\$12,686,753</b>	<b>\$ 1.89</b>	
<b>Affiliate Investments: (k)</b>						
<b>Carolina Skiff LLC (g)</b> Waycross, GA. Manufacturer of fresh water, ocean fishing and pleasure boats. (Manufacturing) <a href="http://www.carolinaskiff.com">www.carolinaskiff.com</a>	\$985,000 Class A preferred membership interest at 14%. Redeemable December 23, 2012. \$500,000 subordinated promissory note at 14% due December 31, 2016. 6.0825% class A common membership interest.	1/30/04	7%	\$ 1,500,000	\$ 1,500,000	\$ .22

[Table of Contents](#)

**RAND CAPITAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED SCHEDULE OF PORTFOLIO INVESTMENTS  
September 30, 2012 (Continued)  
(Unaudited)**

(a) Company, Geographic Location, Business Description, (Industry) and Website	(b) Type of Investment	(b) Date Acquired	(c) Equity 10%	(d) Cost 533,222	(d)(f) Fair Value 533,222	Per Share of Rand .08
<b>Chequed.com, Inc. (e)(g)</b> Saratoga Springs, NY. Predictive employee selection and development software. (Software) <a href="http://www.chequed.com">www.chequed.com</a>	157,464 Series A preferred shares.	11/18/10	10%	533,222	533,222	.08
<b>EmergingMed.com, Inc. (e)(g)</b> New York, NY. Cancer clinical trial matching and referral service. (Software) <a href="http://www.emergingmed.com">www.emergingmed.com</a>	\$675,046 senior subordinated note at 8% due January 19, 2013. Warrants for 8% of common stock.	12/19/05	8%	675,046	337,500	.05
<b>First Wave Products Group, LLC (e)(g)</b> Batavia, NY. Develops medical devices including First Crush, a dual action pill crusher that crushes and grinds medical pills. (Manufacturing) <a href="http://www.firstwaveproducts.com">www.firstwaveproducts.com</a>	\$400,000 senior term note at 10% due April 19, 2016. Warrant for 19,429 capital securities.	4/19/12	5%	410,228	410,228	.06
<b>G-TEC Natural Gas Systems (e)</b> Buffalo, NY. Manufactures and distributes systems that allow natural gas to be used as an alternative fuel to gases. (Manufacturing) <a href="http://www.gas-tec.com">www.gas-tec.com</a>	21.6% Class A membership interest. 8% cumulative dividend.	8/31/99	22%	400,000	100,000	.01
<b>Microcision LLC (g)</b> Philadelphia, PA. Custom manufacturer of medical and dental implants. (Manufacturing). <a href="http://www.microcision.com">www.microcision.com</a>	\$1,500,000 subordinated promissory note at 5%, 6% deferred interest due December 31, 2013. 15% class A common membership interest.	9/24/09	15%	1,756,235	1,756,235	.26
<b>Mid America Brick &amp; Structural Clay Products, LLC (g)</b> Mexico, MO. Manufacturer of face brick for residential and commercial construction. (Manufacturing). <a href="http://www.midamericanabrick.com">www.midamericanabrick.com</a>	19,524,582 membership units. \$250,000 promissory note at 8% due April 4, 2017. Warrant for 6,101.43 membership units.	6/1/10	22%	1,063,698	1,063,698	.16
<b>QuaDPharma, LLC (g)(h)</b> Clarence, NY. Small scale pre-commercial and commercial manufacturing for the Pharmaceutical industry. (Manufacturing) <a href="http://www.quadpharmainc.com">www.quadpharmainc.com</a>	\$250,000 senior subordinated term note at 10% due June 26, 2017. 90 Class A units of membership interest.	6/26/12	10%	493,953	493,953	.07
<b>SOMS Technologies, LLC (e)(g)</b> Valhalla, NY. Produces and markets the microGreen Extended Performance Oil Filter. (Auto Parts Developer) <a href="http://www.microgreenfilter.com">www.microgreenfilter.com</a>	5,959,490 Series B membership units.	12/2/08	10%	472,632	528,348	.08
<b>Other Affiliate Investments</b>				22,841	22,841	.00
<b>Subtotal Affiliate Investments</b>				<u>\$ 7,327,855</u>	<u>\$ 6,746,025</u>	<u>\$ .99</u>
<b>Control Investments (l)</b>						
<b>Advantage 24/7 LLC (e)(g)</b> Williamsville, NY. Marketing program for wine and spirits dealers. (Marketing Company)	50% Membership interest.	12/30/10	50%	\$ 100,000	\$ 100,000	\$ .02
<b>Gemcor II, LLC (g)(h)</b> West Seneca, NY. Designs and sells automatic riveting machines used in the assembly of aircraft components. (Manufacturing) <a href="http://www.gemcor.com">www.gemcor.com</a>	\$500,000 subordinated promissory note at 15% due December 1, 2014. \$1,000,000 subordinated promissory note at 15% due September 1, 2017. 25 membership units. Warrant to purchase 6.25 membership units.	6/28/04	31%	1,753,239	8,253,239	1.22
<b>Other Control Investments</b>				24,515	24,515	.00
<b>Subtotal Control Investments</b>				<u>\$ 1,877,754</u>	<u>\$ 8,377,754</u>	<u>\$ 1.24</u>
<b>Total portfolio investments</b>				<u><u>\$ 16,151,563</u></u>	<u><u>\$ 27,810,532</u></u>	<u><u>\$ 4.12</u></u>

---

## [Table of Contents](#)

### **RAND CAPITAL CORPORATION AND SUBSIDIARY CONDENSED CONSOLIDATED SCHEDULE OF PORTFOLIO INVESTMENTS September 30, 2012 (Continued) (Unaudited)**

#### **Notes to Consolidated Schedule of Portfolio Investments**

- (a) At September 30, 2012 restricted securities represented 77% of the fair value of the investment portfolio. Restricted securities are subject to one or more restrictions on resale and are not freely marketable. Freed Maxick CPAs, P.C. has not examined the business descriptions of the portfolio companies. Individual securities with values less than \$100,000 are included in "Other Investments."
- (b) The Date Acquired column indicates the year in which the Corporation acquired its first investment in the company or a predecessor company. Freed Maxick CPAs, P.C. has not audited the date acquired of the portfolio companies.
- (c) The equity percentages estimate the Corporation's ownership interest in the portfolio investment. The estimated ownership is calculated based on the percent of outstanding voting securities held by the Corporation or the potential percentage of voting securities held by the Corporation upon exercise of warrants or conversion of debentures, or other available data. Freed Maxick CPAs, P.C. has not audited the equity percentages of the portfolio companies. The symbol "<1%" indicates that the Corporation holds an equity interest of less than one percent.
- (d) The Corporation uses Accounting Standards Codification (ASC) 820 "Fair Value Measurements" which defines fair value and establishes guidelines for measuring fair value. At September 30, 2012, ASC 820 designates 23% of the Corporation's investments as "Level 1" and 77% as "Level 3" assets. Under the valuation policy of the Corporation, unrestricted publicly held securities are valued at the average closing bid price for these securities for the last three trading days of the month. Restricted publicly traded securities are valued at the average closing bid price for the last three trading days of the month and are discounted for the time restriction. Restricted securities are subject to restrictions on resale, and are valued at fair value as determined by the management of the Corporation and submitted to the Board of Directors for approval. Fair value is considered to be the amount which the Corporation may reasonably expect to receive for portfolio securities when sold on the valuation date. Valuations as of any particular date, however, are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities and these favorable or unfavorable differences could be material. Among the factors considered in determining the fair value of restricted securities are the financial condition and operating results, projected operations, and other analytical data relating to the investment. Also considered are the market prices for unrestricted securities of the same class (if applicable) and other matters which may have an impact on the value of the portfolio company.
- (e) These investments are non-income producing. All other investments are income producing. Non-income producing investments have not generated cash payments of interest or dividends including LLC tax related distributions within the last twelve months, or are not expected to go forward.
- (f) As of September 30, 2012, the total cost of investment securities approximated \$16.15 million. Net unrealized appreciation was approximately \$11.66 million, which was comprised of \$13.24 million of unrealized appreciation of investment securities and \$1.58 million related to unrealized depreciation of investment securities.
- (g) Rand Capital SBIC, Inc. investment.
- (h) Reduction in cost and value from previously reported balances reflects current principal repayment.
- (i) Represents interest due (amounts over \$50,000 net of reserves) from investment included as interest receivable on the Corporation's Balance Sheet.
- (j) Non-Control/Non-Affiliate investments are investments that are neither Control Investments nor Affiliated Investments.
- (k) Affiliate investments are defined by the Investment Company Act of 1940, as amended ("1940 Act"), as those Non-Control investments in companies in which between 5% and 25% of the voting securities are owned.
- (l) Control investments are defined by the 1940 Act as investments in companies in which more than 25% of the voting securities are owned or where greater than 50% of the board representation is maintained.
- (m) Publicly owned company.
- (n) Effective August 13, 2012 the Corporation's shares in Synacor, Inc. became unrestricted. On September 30, 2012, the Corporation owned 852,362 shares of Synacor that were valued at \$7.58 per share in accordance with the Corporation's valuation policy for publicly held securities. Subsequent to September 30, 2012, Synacor's public share price had a trading range on NASDAQ of \$5.84 to \$7.98 for the period October 1<sup>st</sup> through October 24, 2012. The Corporation's 852,362 shares of Synacor have a public market value of \$5.3 million at October 24, 2012 prior to any income tax considerations.

---

## [\*\*Table of Contents\*\*](#)

### **Rand Capital Corporation and Subsidiary Notes to the Consolidated Financial Statements For the Nine Months Ended September 30, 2012 and 2011 (Unaudited)**

#### **Note 1. ORGANIZATION**

Rand Capital Corporation (“Rand”) was incorporated under the laws of New York in 1969. Beginning in 1971, Rand operated as a publicly traded, closed-end, diversified management company that was registered under Section 8 of the Investment Company Act of 1940 (the “1940 Act”). In 2001 Rand elected to be treated as a business development company (“BDC”) under the 1940 Act. In 2002, Rand formed a wholly-owned subsidiary for the purpose of operating it as a small business investment company (“SBIC”) licensed by the U.S. Small Business Administration (“SBA”). The subsidiary received an SBA license to operate as an SBIC in August 2002. The subsidiary, which had been organized as a Delaware limited partnership, was converted into a New York corporation on December 31, 2008, at which time its operations as a licensed small business investment company were continued by the newly formed corporation under the name of Rand Capital SBIC, Inc. (“Rand SBIC”). The following discussion describes the operations of Rand and its wholly-owned subsidiary Rand SBIC (collectively, the “Corporation”).

The Corporation is listed on the NASDAQ Capital Market under the symbol “Rand”.

#### **SBIC Subsidiary**

Since 2002, Rand has operated a wholly-owned SBIC subsidiary in order to have access to the various forms of leverage provided by the SBA to SBICs. Rand operates Rand SBIC, and Rand formerly operated the limited partnership SBIC predecessor of Rand SBIC, for the same investment purposes and with investments in the same kinds of securities as Rand. The operations of the SBIC predecessor were, and the operations of Rand SBIC are, consolidated with those of Rand for both financial reporting and tax purposes.

In 2002 Rand and the predecessor SBIC subsidiary filed an initial Exemption Application with the Securities and Exchange Commission (SEC) seeking an order for a number of operating exemptions that the SEC has commonly granted from certain restrictions under the 1940 Act that would otherwise limit the operations of the wholly-owned subsidiary. After the filing of the Exemption Application, the Corporation had extensive discussions with the staff of the Division of Investment Management of the SEC concerning the application. The principal substantive issue in these discussions was the structure of the predecessor of Rand SBIC as a limited partnership.

Rand formed the predecessor SBIC in 2002 as a limited partnership because that was the organizational form that the SBA strongly encouraged for all new entities seeking licenses as SBICs. Rand organized the SBIC subsidiary in a manner that was consistent with the SBA’s model limited partnership forms for licensed SBICs. In that structure, the general partner of Rand SBIC was a limited liability company whose managers were the principal executive officers of Rand.

Under the rules and interpretations of the SEC applicable to BDCs (which the subsidiary SBIC intended to become), if a BDC is structured in limited partnership form, then it must have general partners who serve as a board of directors, or a general partner with very limited authority and a separate board of directors, all of the persons who serve on the board of directors must be natural persons, and a majority of the directors must not be “interested persons” of the BDC. Since the managers of the limited liability company general partner of the SBIC subsidiary were the principal executive officers of Rand, and since both the limited liability company general partner and the subsidiary SBIC were wholly-owned by Rand, Rand believed that the board of directors of Rand was the functional equivalent of a board of directors for both the general partner limited liability company and for the SBIC limited partnership.

---

## [Table of Contents](#)

Nevertheless, the staff of the Division of Investment Management of the SEC maintained the view that if the limited partnership subsidiary was to be operated as a limited partnership BDC in compliance with the 1940 Act, then the organizational documents of the limited partnership would have to specifically provide that it would have a board of directors consisting of natural persons, a majority of whom would not be “interested persons.”

With the approval of the SBA, effective December 31, 2008, Rand merged the Rand SBIC limited partnership into a new corporation whose board of directors is the same as that of Rand. The SBA formally approved the re-licensing of the new corporation as an SBIC in February 2009. As a result of the merger, Rand SBIC is a wholly-owned corporate subsidiary of Rand, and its board of directors is comprised of the directors of Rand, a majority of whom are not “interested persons” of Rand or Rand SBIC.

Following this merger, in February 2009, the Corporation filed a new Exemption Application with the SEC, which was amended in August 2009, September 2011, and again in January 2012 in response to comments from the Staff of the SEC. As amended, the Exemption Application sought an order under Sections 6(c), 12(d)(1)(J) and 57(c) of the 1940 Act for exemptions from the application of Sections 12(d)(1)(A) and (C), 18(a), 21(b), 57(a)(1) through (3), and 61(a) of the 1940 Act, and under Section 57(i) of the 1940 Act and Rule 17d-1 under the 1940 Act to permit certain joint transactions that would otherwise be prohibited by Section 57(a)(4) of the 1940 Act, but which would not be prohibited if Rand and Rand SBIC were a single entity. The application also sought an order under Section 12(h) of the Securities Exchange Act of 1934 Act (the “Exchange Act”) for an exemption from separate reporting requirements for Rand SBIC under Section 13(a) of the Exchange Act. In general, the Corporation’s application sought exemptions that would permit:

- Rand and Rand SBIC to engage in certain related party transactions that the Corporation would otherwise be permitted to engage in as a BDC if its component parts were organized as a single corporation;
- Rand, as a BDC, and Rand SBIC, as its BDC/SBIC subsidiary, to meet asset coverage requirements for senior securities on a consolidated basis; and
- Rand SBIC, as a BDC/SBIC subsidiary of Rand as a BDC, to file Exchange Act reports on a consolidated basis as part of Rand’s Exchange Act reports.

On February 1, 2012, the SEC issued Release No. 29941 thereby giving notice of application for the grant of an order permitting the joint operations of Rand and Rand SBIC under the exemptions from the provisions of the 1940 Act described above in the Exemption Application. On February 28, 2012, the SEC granted an Order of Exemption for Rand with respect to the operations of Rand SBIC.

At that time, although Rand SBIC was operated as if it were a BDC, it was registered as an investment company under the 1940 Act. Upon the Corporation’s receipt of the order granting the exemptions described above, on March 28, 2012, Rand SBIC filed an election to be regulated as a BDC under the 1940 Act pursuant to which it may now engage in certain transactions which would be permitted if Rand and Rand SBIC were operated as a single entity, but which are not permitted between a parent BDC and a wholly-owned subsidiary BDC without specific exemptions.

## **Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**—In Management’s opinion, the accompanying consolidated financial statements include all adjustments necessary for a fair presentation of the consolidated financial position, results of operations, and cash flows for the interim periods presented. Certain information and note disclosures normally included in audited annual financial statements prepared in accordance with United States generally accepted accounting principles (“GAAP”) have been omitted; however, the Corporation believes that the disclosures made are adequate to make the information presented not misleading. The interim results for the nine months ending September 30, 2012 are not necessarily indicative of the results for the full year.

---

## [Table of Contents](#)

These statements should be read in conjunction with the consolidated financial statements and the notes included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011. Information contained in this filing should also be reviewed in conjunction with the Corporation's related filings with the SEC prior to the date of this report. Those filings include, but are not limited to, the following:

N-54A	Election to Adopt Business Development Company status
DEF-14A	Definitive Proxy Statement submitted to shareholders
Form 10-K	Annual Report on Form 10-K for the year ended December 31, 2011
Form 10-Q	Quarterly Report on Form 10-Q for the quarters ended June 30, 2012, March 31, 2012, and September 30, 2011

The Corporation's website is [www.randcapital.com](http://www.randcapital.com). The Corporation's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, charters for the Corporation's Board committees and other reports filed with the Securities and Exchange Commission ("SEC") are available through the Corporation's website.

**Principles of Consolidation**—The consolidated financial statements include the accounts of Rand and its wholly-owned subsidiary Rand SBIC. All intercompany accounts and transactions have been eliminated in consolidation.

**Reclassification**—Certain prior year income statement amounts have been reclassified to comply with SEC and certain accounting rules.

**Cash and Cash Equivalents**—Temporary cash investments having a maturity of three months or less when purchased are considered to be cash equivalents.

**Revenue Recognition—Interest Income**—Interest income generally is recognized on the accrual basis except where the investment is in default or otherwise presumed to be in doubt. In such cases, interest is recognized at the time of receipt. A reserve for possible losses on interest receivable is maintained when appropriate.

The Rand SBIC interest accrual is also regulated by the SBA's "Accounting Standards and Financial Reporting Requirements for Small Business Investment Companies." Under these rules interest income cannot be recognized if collection is doubtful, and a 100% reserve must be established. The collection of interest is presumed to be in doubt when there is substantial doubt about a portfolio company's ability to continue as a going concern or the loan is in default more than 120 days. Management also uses other qualitative and quantitative measures to determine the value of a portfolio investment and the collectability of any accrued interest.

**Revenue Recognition—Dividend Income**—The Corporation may receive distributions from portfolio companies that are limited liability companies and corporations and these distributions are classified as dividend income on the statement of operations. Dividend income is recognized on an accrual basis when it can be reasonably estimated.

**Original Issue Discount**—Investments may include "original issue discount" or OID income. This occurs when the Corporation purchases a warrant and a note from a portfolio company simultaneously, which require an allocation of a portion of the purchase price to the warrant and reduces the note or debt instrument by an equal amount in the form of a note discount or OID. The note is reported net of the OID and the OID is accreted into interest income over the life of the loan. The Corporation recorded two OID's for the nine months ended September 30, 2012 for \$159,000 and had OID income for the same period of \$15,988. The Corporation recognized \$37,000 in OID income for the nine months ended September 30, 2011.

---

## [Table of Contents](#)

**Deferred Debenture Costs**—SBA debenture origination and commitment costs, which are included in other assets, are amortized ratably over the terms of the SBA debentures and are expensed when the debt is repaid. Amortization expense for the nine months ended September 30, 2012 and 2011 was \$59,902 and \$91,135, respectively.

**SBA Leverage**—The Corporation has \$3,900,000 in outstanding SBA leverage at September 30, 2012 and \$4,000,000 at December 31, 2011. Of the outstanding \$3,900,000 in leverage, \$900,000 of this leverage has an interest rate of 4.4% and will mature in 2020 and the remaining \$3,000,000 has an interest rate of 3% and will mature in 2022. The total remaining SBA commitment at September 30, 2012 is \$5,000,000. This outstanding leverage commitment expires on September 30, 2016.

**Net Assets per Share**—Net assets per share are based on the number of shares of common stock outstanding. There are no common stock equivalents.

**Supplemental Cash Flow Information**—Income taxes paid (refunded) during the nine months ended September 30, 2012 and 2011 amounted to \$15,296 and (\$426,619), respectively. Interest paid during the nine months ended September 30, 2012 and 2011 amounted to \$135,870 and \$555,748, respectively. The Corporation converted \$84,655 and \$72,285 of interest receivable into investments during the nine months ended September 30, 2012 and 2011, respectively.

**Accounting Estimates**—The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Stockholders' Equity (Net Assets)**—At September 30, 2012 and December 31, 2011, there were 500,000 shares of \$10.00 par value preferred stock authorized and unissued.

The Board of Directors has authorized the repurchase of up to 340,946 shares of the Corporation's outstanding common stock on the open market through October 28, 2012 at prices that are no greater than current net asset value. During 2003 and 2002 the Corporation purchased 44,100 shares of its stock for \$47,207. In the third quarter of 2012, the Corporation purchased an additional 60,942 shares for \$157,158 at an average market price of \$2.58. At September 30, 2012 the total treasury shares were 105,042 with a total cost of \$204,365.

**Profit Sharing and Stock Option Plan**—In 2001 the stockholders of the Corporation authorized the establishment of an Employee Stock Option Plan (the "Option Plan"), that provides for the award of options to purchase up to 200,000 common shares to eligible employees. In 2002, the Corporation placed the Option Plan on inactive status as it developed a new profit sharing plan for the Corporation's employees in connection with the formation of its SBIC subsidiary. As of September 30, 2012, no stock options had been awarded under the Option Plan. Because Section 57(n) of the 1940 Act prohibits maintenance of a profit sharing plan for the officers and employees of a BDC where any option, warrant or right is outstanding under an executive compensation plan, no options will be granted under the Option Plan while any profit sharing plan is in effect with respect to the Corporation.

In 2002, the Corporation established a Profit Sharing Plan (the "Plan") for its executive officers in accordance with Section 57(n) of the 1940 Act. Under the Plan, the Corporation will pay its executive officers aggregate profit sharing payments equal to 12% of the net realized capital gains of its SBIC subsidiary, net of all realized capital losses and unrealized depreciation of the SBIC subsidiary, for the fiscal year, computed in accordance with the Plan and the Corporation's interpretation of the Plan. Any profit sharing paid or accrued cannot exceed 20% of the Corporation's net income, as defined. The profit sharing payments will be split equally between the Corporation's two executive officers, who are fully vested in the Plan.

---

## [Table of Contents](#)

The Corporation accrued \$144,000 under the Plan for the nine months ended September 30, 2012. There were no amounts earned pursuant to the Plan for the nine months ended September 30, 2011. During the year ended December 31, 2010, the Corporation approved and accrued \$584,634 under the profit sharing plan, of which \$568,694 was paid during the nine months ended September 30, 2011. The remaining \$15,940 accrued at September 30, 2012 is related to an escrow receivable and will be paid when the escrow is collected.

**Income Taxes**—The Corporation reviews the tax positions it has taken to determine if they meet a “more likely than not threshold” for the benefit of the tax position to be recognized in the financial statements. A tax position that fails to meet the more likely than not recognition threshold will result in the recording of either a reduction of an income tax receivable or a deferred tax asset, or an income tax payable or a deferred tax liability.

It is the Corporation’s policy to include interest and penalties related to income tax liabilities in income tax expense. There were no amounts recognized for interest or penalties related to unrecognized tax expense for the nine months ended September 30, 2012 and 2011.

In September 2012 the Internal Revenue Service completed an audit of the Corporation’s tax returns for the years ended December 31, 2008 through December 31, 2010, which resulted in a decrease of \$64,000 in liabilities for uncertain tax positions during the nine months ended September 30, 2012. All adjustments related to that audit were recorded in the tax provision at September 30, 2012. The Corporation is currently open to audit under the statute of limitations by the Internal Revenue Service for the year ending December 31, 2011. In general, the Corporation’s state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2008 through 2011. The Corporation does not expect that the amounts of uncertain tax positions will change significantly within the next 12 months.

**Concentration of Credit and Market Risk**—The Corporation’s financial instruments potentially subject it to concentrations of credit risk. Cash is invested with banks in amounts which, at times, exceed insurable limits. Management does not anticipate non-performance by the banks.

At September 30, 2012 investments in Gemcor II, LLC (Gemcor), Synacor Inc. (Synacor), Liazon Corporation (Liazon), Microcision, LLC (Microcision) and Carolina Skiff LLC (Carolina Skiff) represent 30%, 23%, 8%, 6% and 5%, respectively, of the fair value of the Corporation’s investment portfolio.

**Recent Accounting Pronouncements**—In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, Fair Value Measurements (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs) (ASU 2011-04). ASU 2011-04 results in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. The adoption of ASU 2011-04 did not have a significant impact on our financial condition and results of operations. See Note 3. Investments for further information regarding valuation technique and quantitative information about the significant unobservable inputs utilized by the Corporation to value Level 3 investments.

**Subsequent Events**—Subsequent to quarter end, the Corporation drew down \$1,000,000 in additional SBA leverage and made two investments in two portfolio companies for \$1,200,000. Additionally, the Corporation repurchased 144,208 shares of its common stock, after quarter end, for the treasury and extended the stock buyback program through November 1, 2013 to accumulate up to an aggregate of 500,000 shares of its common stock.

---

## [\*\*Table of Contents\*\*](#)

Also, subsequent to the end of the quarter, Synacor (SYNC:NASDAQ GM), a portfolio investment held by the Corporation, had a trading range on NASDAQ of \$5.84 to \$7.98 for the period October 1, 2012 through October 24, 2012.

Based on the October 24, 2012 NASDAQ closing market price of \$6.16/share the Corporation's 852,362 shares of Synacor common stock had a fair market value of approximately \$5.25 million, a decrease of approximately \$1.21 million from the valuation at September 30, 2012, prior to any income tax and other considerations. Based on the Corporation's 6,757,992 shares outstanding at September 30, 2012, the reduction in Synacor's value at October 24, 2012 would have an estimated tax effected impact of reducing the Corporation's September 30, 2012 Net Asset Value per share by approximately (\$0.12).

Valuations as of any particular date are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities and these favorable or unfavorable difference could be material.

### **Note 3. INVESTMENTS**

Investments are valued at fair value as determined in good faith by the Management of the Corporation and submitted to the Board of Directors for approval. The Corporation invests in loan instruments, debt instruments, and equity instruments. There is no single standard for determining fair value in good faith. As a result, determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment while employing a consistent valuation process for each investment. The Corporation analyzes and values each investment quarterly, and records unrealized depreciation for an investment that it believes has become impaired, including where collection of a loan or realization of the recorded value of an equity security is doubtful. Conversely, the Corporation will record unrealized appreciation if it believes that an underlying portfolio company has appreciated in value and, therefore, its equity security has also appreciated in value. These estimated fair values may differ from the values that would have been used had a ready market for the investments existed and these differences could be material if the Corporation's assumptions and judgments differ from results of actual liquidation events.

The Corporation previously adopted Accounting Standards Codification (ASC) 820, "fair value measurements and disclosures", which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements.

Loan investments are defined as traditional loan financings with no equity features. Debt investments are defined as debt financings that include one or more equity features such as conversion rights, stock purchase warrants, and/or stock purchase options. A financing may also be categorized as a debt financing if it is accompanied by the direct purchase of an equity interest in the company.

The Corporation uses several approaches to determine the fair value of an investment. The main approaches are:

- Loan and debt securities are valued at cost when it is representative of the fair value of an investment or sufficient assets or liquidation proceeds exists from a sale of a portfolio company at its estimated fair value.  
The loan and debt securities may also be valued at an amount other than the price the security would command in order to provide a yield to maturity equivalent to the current yield of similar debt securities. A loan or debt instrument may be reduced in value if it is judged to be of poor quality, collection is in doubt or insufficient liquidation proceeds exist.
- Equity securities may be valued using the "market approach" or "income approach." The market approach uses observable prices and other relevant information generated by similar market transactions. It may include the use of market multiples derived from a set of comparables to assist in pricing the investment. Additionally, the Corporation adjusts valuations if a subsequent significant equity financing has occurred that includes a meaningful portion of the financing by a sophisticated, unrelated new investor. The income approach employs a cash flow and discounting methodology to value an investment.

---

## [Table of Contents](#)

ASC 820 classifies the inputs used to measure fair value into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities, used in the Corporation's valuation at the measurement date.

Level 2: Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical or similar assets or liabilities in markets that are not active, or other observable inputs other than quoted prices.

Level 3: Unobservable and significant inputs to determining the fair value.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement, which is not necessarily an indication of risks associated with the investment.

Any changes in estimated fair value are recorded in the statement of operations as "Net increase (decrease) in unrealized appreciation."

Under the valuation policy, the Corporation values unrestricted publicly held securities at the average closing bid price for these securities for the last three trading days of the month. Restricted publicly held securities are valued at the average closing bid price for the last three trading days of the month and are discounted for the time restriction. See subsequent event footnote disclosure regarding Synacor.

In the valuation process, the Corporation values private securities using the financial information from these portfolio companies, which may include audited and unaudited financial statements, annual projections and budgets prepared by the portfolio company and other financial and non-financial business information supplied by the companies' management. This information is used to determine financial condition, performance, and valuation of the portfolio companies. The valuation may be reduced if a company's performance and potential have deteriorated significantly. If the factors which led to the reduction in valuation are overcome, the valuation may be restored.

The fair value determination of each portfolio investment categorized as Level 3 required one or more of the following unobservable inputs:

- Financial information obtained from each portfolio company, including unaudited statements of operations, balance sheets and operating budgets;
- Current and projected financial, operational and technological development of the portfolio company;
- Current and projected ability of the portfolio company to service its debt obligations;
- The current capital structure of the business and the seniority of the various classes of equity if a deemed liquidation event were to occur;
- Pending debt or capital restructuring of the portfolio company;
- Current information regarding any offers to purchase the investment; or past sales transactions.

---

## Table of Contents

- Current ability of the portfolio company to raise any additional financing if needed;
- Changes in the economic environment which may have a material impact on the operating results of the portfolio company;
- Internal occurrences that may have an impact (both positive and negative) on the operating performance of the portfolio company;
- Qualitative assessment of key management;
- Contractual rights, obligations or restrictions associated with the investment; and
- Other factors deemed relevant.

### Equity Securities

Equity Securities may include Preferred Stock, Common Stock, Warrants & Limited Liability Company Interests

The significant unobservable inputs used in the fair value measurement of our equity investments are EBITDA and revenue multiples where applicable, the financial and operational performance of the business, or the senior equity preferences which may exist in a deemed liquidation event. Standard industry multiples may be used when available, however the Corporation's portfolio companies are typically small and in early stages of development and these industry standards may be adjusted to more closely match the specific financial and operational performance of the portfolio company. Due to the nature of certain investments, fair value measurements may be based on other criteria, which may include third party appraisals. Significant changes to the unobservable inputs may result in a significantly higher or lower fair value measurement.

Another key factor used in valuing equity investments is recent arms-length equity transactions with unrelated new investors entered into by the portfolio company. Many times the terms of these equity transactions may not be identical to the equity transactions between the portfolio company and the Corporation, and the impact of the discrepancy in transaction terms on the market value of the portfolio company may be difficult or impossible to quantify.

When appropriate the Black-Scholes pricing model is utilized to estimate the fair value of warrants for GAAP accounting purposes. This model requires the use of highly subjective inputs including expected volatility, expected life, expected dividend rate and expected risk free rate of return in addition to variables for the valuation of minority equity positions in small private and early stage companies. Significant increases (decreases) in any of these unobservable inputs would result in a significantly higher or lower fair value measurement.

For recent investments, we generally rely on the cost basis, which is deemed to represent the fair value, unless other fair market value inputs are identified causing the Corporation to depart from this level.

### Loan and Debt Securities

The significant unobservable inputs used in the fair value measurement of the Corporation's debt securities are the financial and operational performance of the portfolio company as well as the market acceptance for the portfolio company's products or service. These inputs will provide an indicator as to the probability of principal recovery of the investment. The Corporation's debt investments will often be junior secured or unsecured debt securities, lacking sufficient collateral. Fair value may also be determined based on other criteria where appropriate. Significant changes to the unobservable inputs may result in a significantly higher or lower fair value measurement. For recent investments, we generally rely on the cost basis, which is deemed to represent the fair value, unless other fair market value inputs are identified causing the Corporation to depart from this level.

## [Table of Contents](#)

The following table provides a summary of the significant unobservable inputs used to fair value the Corporation's Level 3 portfolio investments as of September 30, 2012:

<u>Investment Type</u>	<u>Fair Value at September 30, 2012</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>Range</u>
Equity Investments	\$ 7,786,748	Market Approach	EBITDA Multiple	5X-12X
	\$ 1,472,274	Market Approach	Liquidation Seniority	1X
	\$ 100,000	Market Approach	Revenue Multiple	1X
	\$ 7,113,707	Market Approach	Transaction Pricing	Not applicable
	\$ 22,000	Black Scholes		
	\$ 4,518,353	Pricing Model	Stock pricing	\$1.13
Debt Investments	\$ 337,500	Face Value	Recent Transaction Pricing	Not applicable
Total	<u>\$ 21,350,582</u>	Market Approach	Revenue Multiple	1X

**The following tables provide a summary of the components of Level 1, 2 and 3 Assets Measured at Fair Value on a Recurring Basis at September 30, 2012**

<u>Description</u>	<u>September 30, 2012</u>	<u>Fair Value Measurements at Reported Date Using</u>		
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Observable Inputs (Level 2)</u>	<u>Other Significant Unobservable Inputs (Level 3)</u>
Loan investments	\$ 1,497,192	—	—	\$ 1,497,192
Debt investments	3,358,661	—	—	3,358,661
Equity investments	22,954,679	6,459,950	—	16,494,729
Total Venture Capital Investments	<u>\$27,810,532</u>	<u>\$ 6,459,950</u>	<u>\$ 0</u>	<u>\$21,350,582</u>

**The following tables provide a summary of the components of Level 1, 2 and 3 Assets Measured at Fair Value on a Recurring Basis at December 31, 2011 :**

<u>Description</u>	<u>December 31, 2011</u>	<u>Fair Value Measurements at Reported Date Using</u>		
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Observable Inputs (Level 2)</u>	<u>Other Significant Unobservable Inputs (Level 3)</u>
Loan investments	\$ 327,111	—	—	\$ 327,111
Debt investments	2,854,564	—	—	2,854,564
Equity investments	20,750,186	—	—	20,750,186
Total Venture Capital Investments	<u>\$23,931,861</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$23,931,861</u>

## [Table of Contents](#)

The Following tables provide a summary of Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3) for the nine months ended September 30, 2012:

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			
	Venture Capital Investments			
	Loan Investments	Debt Investments	Equity Investments	Total
<b>Beginning Balance, December 31, 2011, of Level 3 Assets</b>	\$ 327,111	\$2,854,564	\$20,750,186	\$ 23,931,861
<b>Unrealized gains or losses included in net change in net assets from operations</b>				
Liazon Corporation (Liazon)	—	—	833,332	833,332
Ultra-Scan Corporation (UltraScan)	—	—	(513,246)	(513,246)
EmergingMed.com, Inc. (Emerging Med)	—	(337,546)	—	(337,546)
<b>Total Unrealized Gains and Losses</b>	—	(337,546)	320,086	(17,460)
<b>Purchases/Changes to Securities (A)</b>				
Gemcor II, LLC (Gemcor)	1,000,000	—	—	1,000,000
QuaDPharma, LLC (Quadpharma)	250,000	—	250,000	500,000
Rheonix, Inc. (Rheonix)	—	—	455,728	455,728
First Wave Products Group, LLC (First Wave)	—	388,227	22,000	410,227
Liazon	—	—	275,000	275,000
Mezmeriz, Inc. (Mezmeriz)	—	250,000	—	250,000
Mid America Brick & Structural Clay Products, LLC (Mid America Brick)	—	126,698	137,000	263,698
Microcision LLC (Microcision)	—	76,718	—	76,718
<b>Total Purchases/Changes to Securities</b>	1,250,000	841,643	1,139,728	3,231,371
<b>Repayments of Securities</b>				
Gemcor	(73,872)	—	—	(73,872)
QuaDPharma	(6,047)	—	—	(6,047)
NDT Acquisitions, LLC (NDT)	—	—	(15,271)	(15,271)
<b>Total Repayments of Securities</b>	(79,919)	—	(15,271)	(95,190)
<b>Transfers within Level 3</b>				
<b>Transfers in or out of Level 3 (B) (C)</b>	—	—	—	—
<b>Ending Balance, September 30, 2012, of Level 3 Assets</b>	<u>\$1,497,192</u>	<u>\$3,358,661</u>	<u>\$16,494,729</u>	<u>\$ 21,350,582</u>
Change in unrealized gains or losses for the period included in changes in net assets				(\$ 17,460)
Total gains or losses for the period included in changes in net assets				—

- (A) Includes the impact of non-cash conversions.
- (B) The reporting entity's policy is to recognize transfers into and transfers out of level 3 as of the date of the event or change in circumstances that caused the transfer.
- (C) Transfer from level 3 to level 2 during the first quarter of 2012 because observable market data became available for the restricted security. The Synacor, Inc. shares became freely tradable during August 2012 and were transferred from Level 2 to Level 1 at September 30, 2012.

[Table of Contents](#)

The Following tables provide a summary of Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3) for the nine months ended September 30, 2011.

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Venture Capital Investments			
	Loan Investments	Debt Investments	Equity Investments	Total
<b>Beginning Balance, December 31, 2010, of Level 3 Assets</b>	\$413,597	\$3,595,326	\$15,355,702	\$19,364,625
<b>Realized Gains or Losses included in net change in net assets from operations</b>				
Associates Interactive (Associates)	—	—	(293,518)	(293,518)
Niagara Dispensing Technologies, Inc. (Niagara Dispensing)	—	(498,828)	(1,281,785)	(1,780,613)
<b>Total Realized Losses</b>	—	(498,828)	(1,575,303)	(2,074,131)
<b>Unrealized gains or losses included in net change in net assets from operations</b>				
Associates	—	—	293,518	293,518
Liazon Corporation (Liazon)	—	—	141,801	141,801
Niagara Dispensing	—	447,328	1,281,785	1,729,113
Synacor, Inc. (Synacor)	—	—	1,531,999	1,531,999
<b>Total Unrealized Gains and Losses</b>	—	447,328	3,249,103	3,696,431
<b>Purchases/Changes to Securities/Non-cash conversions</b>				
Chequed.com, Inc. (Chequed)	—	250,000	—	250,000
Microcision LLC (Microcision)	—	72,285	—	72,285
Liazon	—	37,000	819,999	856,999
SOMS Technologies, LLC	—	—	101,945	101,945
<b>Total Purchases/Changes to Securities and Non-Cash conversions</b>	—	359,285	921,944	1,281,229
<b>Repayments of Securities</b>				
Gemcor II, LLC (Gemcor)	(71,162)	—	—	(71,162)
Liazon	—	(500,000)	—	(500,000)
<b>Total Repayments of Securities</b>	(71,162)	(500,000)	—	(571,162)
<b>Transfers within Level 3</b>				
<b>Transfers in or out of Level 3</b>				
<b>Ending Balance, September 30, 2011, of Level 3 Assets</b>	<u>\$342,435</u>	<u>\$3,403,111</u>	<u>\$17,951,446</u>	<u>\$21,696,992</u>

## [Table of Contents](#)

Amount of total gains or losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date and reported within the net realized and unrealized gains or losses on investments in the Condensed Consolidated Statement of Operations	\$ 3,696,431
Amount of realized losses included in changes in net assets from operations for the period reported above within the net realized and unrealized gains or losses on investments in the Condensed Consolidated Statement of Operations	<u>(2,074,131)</u>
Change in unrealized gains or losses relating to assets still held at reporting date	<u>\$ 1,622,300</u>

### Note 4. FINANCIAL HIGHLIGHTS

The following schedule provides the financial highlights, calculated based on weighted average shares outstanding, for the nine months ended September 30, 2012 and the year ended December 31, 2011:

	Nine months ended September 30, 2012 <u>(Unaudited)</u>	Year ended December 31, 2011
Income from investment operations (1):		
Investment income	\$ 0.32	\$ 0.19
Expenses	<u>0.18</u>	<u>0.24</u>
Investment gain (loss) before income taxes	0.14	(0.05)
Income tax expense (benefit)	<u>0.05</u>	<u>(0.04)</u>
Net investment gain (loss)	0.09	(0.01)
Purchase of treasury shares	(0.02)	0.00
Net realized and unrealized gain on investments	<u>0.16</u>	<u>0.21</u>
Increase in net asset value	0.23	0.20
Net asset value, beginning of period, based on weighted average shares	<u>3.58</u>	<u>3.38</u>
Net asset value, end of period, based on weighted average shares	<u>\$ 3.81</u>	<u>\$ 3.58</u>
Per share market price, end of period	<u>\$ 2.71</u>	<u>\$ 3.10</u>
Total return based on market value	(12.58)%	(4.02)%
Total return based on net asset value	6.27%	5.85%
Supplemental data:		
Ratio of expenses before income taxes to average net assets	4.78%	7.00%
Ratio of expenses including taxes to average net assets	5.63%	5.79%
Ratio of net investment gain (loss) to average net assets	3.05%	(0.34)%
Portfolio turnover	12.5%	11.7%
Net assets, end of period	\$ 25,928,752	\$ 24,399,121
Weighted average shares outstanding, end of period	6,812,457	6,818,934

(1) Per share data are based on weighted average shares outstanding and the results are rounded

The Corporation's interim period results could fluctuate as a result of a number of factors; therefore results for any interim period should not be relied upon as being indicative of performance in future periods.

---

## [Table of Contents](#)

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

You should read the following discussion and analysis of the Corporation's financial condition and results of operations in conjunction with the Corporation's consolidated financial statements and related notes included elsewhere in this report.

#### **FORWARD LOOKING STATEMENTS**

*Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report that do not relate to present or historical conditions are "forward-looking statements" within the meaning of that term in Section 27A of the Securities Act of 1933, and in Section 21F of the Securities Exchange Act of 1934. Additional oral or written forward-looking statements may be made by the Corporation from time to time, and forward-looking statements may be included in documents that are filed with the Securities and Exchange Commission. Forward-looking statements involve risks and uncertainties that could cause results or outcomes to differ materially from those expressed in the forward-looking statements. Forward-looking statements may include, without limitation, statements relating to the Corporation's plans, strategies, objectives, expectations and intentions and are intended to be made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words such as "believes," "forecasts," "intends," "possible," "expects," "estimates," "anticipates," or "plans" and similar expressions are intended to identify forward-looking statements. Among the important factors on which such statements are based are assumptions concerning the state of the national economy and the local markets in which the Corporation's portfolio companies operate, the state of the securities markets in which the securities of the Corporation's portfolio companies trade or could be traded, liquidity within the national financial markets, and inflation. Forward-looking statements are also subject to the risks and uncertainties described under the caption "Risk Factors" contained in Part II, Item 1A of this report.*

*There may be other factors, not identified, that affect the accuracy of the Corporation's forward-looking statements. Further, any forward-looking statement speaks only as of the date it is made and, except as required by law, the Corporation undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made or to reflect the occurrence of anticipated or unanticipated events or circumstances. New factors emerge from time to time that may cause the Corporation's business not to develop as we expect, and we cannot predict all of them.*

#### **Overview**

The following discussion describes the financial position and operations of Rand Capital Corporation (Rand) and its wholly-owned subsidiary Rand SBIC, Inc. (Rand SBIC) (collectively, the "Corporation").

Rand is incorporated in New York and has elected to operate as a business development company ("BDC") under the 1940 Act. Its wholly-owned subsidiary, Rand SBIC, operates as a small business investment company ("SBIC") regulated by the Small Business Administration ("SBA"). On February 28, 2012, the SEC granted an Order of Exemption for Rand with respect to the operations of Rand SBIC under which Rand SBIC was permitted to elect BDC status. On March 28, 2012, Rand SBIC elected BDC status with the SEC pursuant to which it may now engage in certain transactions which would be permitted if Rand and Rand SBIC were operated as a single entity, but which are not permitted between a parent BDC and a wholly-owned subsidiary BDC without specific exemption.

The Corporation anticipates that most, if not all, of its investments in the next year will be originated through the SBIC subsidiary.

---

## [Table of Contents](#)

### **Business Developments**

During 2011 and the first nine months of 2012 the economy continued to improve following the recession that ended in 2009. Despite an improvement in the economic landscape over the last two years, the recovery may take longer than expected due to the persistently weak labor market and continued tight credit market, particularly for small businesses. To the extent financial market conditions continue to improve, the Corporation believes its financial condition and the financial condition of the portfolio companies should continue to improve as well. It remains difficult to forecast when future exits will happen.

### **Critical Accounting Policies**

The Corporation prepares its consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP), which require the use of estimates and assumptions that affect the reported amounts of assets and liabilities. A summary of the Corporation's critical accounting policies can be found in the Corporation's 2011 Form 10-K under Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

## [Table of Contents](#)

### Financial Condition

#### Overview:

	9/30/12	12/31/11	Increase	%
Total assets	\$33,435,710	\$31,331,957	\$2,103,753	6.7%
Total liabilities	<u>7,506,958</u>	<u>6,932,836</u>	<u>574,122</u>	8.3%
Net assets	<u>\$25,928,752</u>	<u>\$24,399,121</u>	<u>\$1,529,631</u>	6.3%

The Corporation's financial condition is dependent on the success of its portfolio holdings. The following summarizes the Corporation's investment portfolio at the period-ends indicated.

	9/30/12	12/31/11	Increase	%
Investments, at cost	\$16,151,563	\$13,408,682	\$2,742,881	20.5%
Unrealized appreciation, net	<u>11,658,969</u>	<u>10,523,179</u>	<u>1,135,790</u>	10.8%
Investments at fair value	<u>\$27,810,532</u>	<u>\$23,931,861</u>	<u>\$3,878,671</u>	16.2%

The change in investments, at cost, is comprised of the following:

#### New Investments

Gemcor II, LLC (Gemcor)	\$ 1,000,000
QuaDPharma, LLC (QuaDPharma)	500,000
Rheonix, Inc. (Rheonix)	455,728
First Wave Products Group, LLC (First Wave)	400,000
Liazon Corporation (Liazon)	275,000
Mezmeriz, Inc. (Mezmeriz)	250,000
Mid America Brick & Structural Clay Products, LLC (Mid America Brick)	<u>250,000</u>
<b>Total of new investments during the nine months ended September 30, 2012</b>	<b><u>\$ 3,130,728</u></b>

#### Other Changes to Investments:

Microcision LLC (Microcision) interest conversion	\$ 76,718
Mid America Brick OID accretion	13,698
First Wave interest conversion	7,937
First Wave OID accretion	<u>2,290</u>
<b>Total of other changes to investments during the nine months ended September 30, 2012</b>	<b><u>\$ 100,643</u></b>

#### Investment Repaid/Sold or Liquidated:

Synacor, Inc. (Synacor)	(393,301)
Gemcor	(73,871)
NDT Acquisitions LLC (NDT)	(15,271)
QuaDPharma	<u>(6,047)</u>
<b>Total of investments repaid, sold or liquidated during the nine months ended September 30, 2012</b>	<b><u>(\$ 488,490)</u></b>
<b>Total change in investments, at cost, during the nine months ended September 30, 2012</b>	<b><u>\$ 2,742,881</u></b>

Net asset value (NAV) was \$3.84/share at September 30, 2012 versus \$3.58/share at December 31, 2011.

## [Table of Contents](#)

The Corporation paid off \$3,100,000 in SBA leverage with interest rates ranging from 4.4 to 6.4% and subsequently drew down \$3,000,000 with a lower interest rate of 3% during the nine months ended September 30, 2012. The outstanding SBA leverage at September 30, 2012 is \$3,900,000. The leverage drawn down in 2012 will mature in 2022.

The Corporation's total investments at fair value, as estimated by management and approved by the Board of Directors, approximated 107% of net assets at September 30, 2012 compared to 98% of net assets at December 31, 2011.

Cash and cash equivalents approximated 16% of net assets at September 30, 2012 compared to 19% at December 31, 2011.

## **Results of Operations**

### **Investment Income**

The Corporation's investment objective is to achieve long-term capital appreciation on its equity investments while maintaining a current cash flow from its debenture and pass through equity instruments. Therefore, the Corporation invests in a mixture of debenture and equity instruments, which will provide a current return on a portion of the investment portfolio. The equity features contained in the Corporation's investment portfolio are structured to realize capital appreciation over the long-term and may not generate current income in the form of dividends or interest. In addition, the Corporation earns interest income from investing its idle funds in money market instruments held at high grade financial institutions.

#### ***Comparison of the nine months ended September 30, 2012 to the nine months ended September 30, 2011***

	<u>September 30, 2012</u>	<u>September 30, 2011</u>	<u>(Decrease) Increase</u>	<u>%(Decrease) Increase</u>
Interest from portfolio companies	\$ 426,399	\$ 549,845	(\$ 123,446)	(22.5%)
Interest from other investments	6,483	26,909	(20,426)	(75.9%)
Dividend and other investment income	1,745,742	324,856	1,420,886	437.4%
Other income	6,668	14,680	(8,012)	(54.6%)
Total investment income	<u>\$2,185,292</u>	<u>\$ 916,290</u>	<u>\$ 1,269,002</u>	<u>138.5%</u>

Interest from portfolio companies—The portfolio interest income decrease is due to the fact that two investments, Liazon Corporation (Liazon) and Chequed.com (Chequed), were converted from debt instruments to equity instruments in 2011 and therefore did not contribute to interest income during the first, second or third quarters of 2012. The Corporation also ceased accruing interest on its EmergingMed.com, Inc. (EmergingMed) investment during the third quarter of 2012. In addition, during the nine months ended September 30, 2012 the two Carolina Skiff LLC (Carolina Skiff) investments were accruing interest on a lower compounded principal balance. These two investments calculate interest on the principal balance plus the accrued interest and Carolina Skiff paid off approximately \$1.3 million in accrued interest in December 2011. The interest recognized for the two Carolina Skiff instruments for the nine months ended September 30, 2012 was \$163,676 versus \$271,201 for the same period in 2011.

## Table of Contents

After reviewing the portfolio companies' performance and the circumstances surrounding the investments, the Corporation has ceased accruing interest income on the following investment instrument:

<u>Company</u>	<u>Interest Rate</u>	<u>Investment Cost</u>	<u>Year that Interest Accrual Ceased</u>
G-Tec Natural Gas Systems (G-Tec)	8%	\$400,000	2004
EmergingMed.com, Inc. (EmergingMed)	10%	675,046	2012

Interest from other investments—The decrease in interest from other investments is primarily due to lower cash balances throughout the first nine months of 2012. The cash balance at September 30, 2012 and 2011 was \$4,042,981 and \$4,504,418, respectively.

Dividend and other investment income—Dividend income is comprised of distributions from Limited Liability Companies (LLCs) in which the Corporation has invested. The Corporation's investment agreements with certain LLCs require the LLCs to distribute funds to the Corporation for payment of income taxes on its allocable share of the LLCs profits. These portfolio companies may also elect to distribute additional discretionary distributions. These dividends will fluctuate based upon the profitability of the LLCs and the timing of the distributions. In addition, in the current year the Corporation has begun to receive dividends from a non-LLC portfolio company.

Dividend income for the nine months ended September 30, 2012 consisted of a distribution from Gemcor II, LLC (Gemcor) for \$1,559,964, New Monarch Machine Tool, Inc. (Monarch) for \$169,023, Carolina Skiff LLC (Carolina Skiff) for \$9,163, Somerset Gas Transmission Company, LLC (Somerset) for \$6,950 and NDT for \$642. Dividend income for the nine months ended September 30, 2011 consisted of a distribution from Monarch for \$146,182, Gemcor for \$174,357 and Carolina Skiff for \$4,317. The Corporation exited its debt investment in Monarch in 2008 and still retains a small ownership in the company. Monarch started distributing its profits to its investors during 2011.

Other income—Other income consists of the revenue associated with the amortization of financing fees charged to the portfolio companies upon successful closing of Rand SBIC financings and income associated with board attendance fees. The income associated with the amortization of financing fees was \$667 and \$5,650 for the nine months ended September 30, 2012 and 2011, respectively. The board fees were \$6,000 and \$9,000 for the nine months ended September 30, 2012 and 2011, respectively.

## **Operating Expenses**

### ***Comparison of the nine months ended September 30, 2012 to the nine months ended September 30, 2011***

	<u>September 30, 2012</u>	<u>September 30, 2011</u>	<u>Decrease</u>	<u>% Decrease</u>
Total Expenses	\$1,202,052	\$1,301,529	(\$99,477)	(7.6%)

Operating expenses predominately consist of interest expense on outstanding SBA borrowings, compensation expense, and general and administrative expenses including shareholder and office expenses and professional fees.

The decrease in operating expenses during the nine months ended September 30, 2012 is comprised primarily of a 73% or (\$348,187) decrease in SBA interest expense. Interest expense decreased due to the fact that the Corporation paid off a total of \$9,100,000 in SBA leverage in September 2011 and March 2012 and drew down \$3,000,000 in SBA leverage during 2012. This decrease is offset by a \$144,000 increase in Bonus and Profit Sharing expense and a 26% or \$17,250 increase in Directors' Fees. Bonus and Profit Sharing expense increased due to the accrual of \$144,000 in profit sharing obligations for the nine months ended September 30, 2012. The Directors' Fee expense increased due to an increase in the Directors' fee structure during the current year.

## Table of Contents

### **Net Realized Gains and Losses on Investments**

During the nine months ended September 30, 2012, the Corporation recognized a realized gain of \$415,097 on the sale of 133,825 shares of Synacor, Inc. (Synacor). Synacor completed an Initial Public Offering (IPO) at \$5.00 on February 10, 2012 trading on the NASDAQ Global Market under the symbol “SYNC”. The Corporation owned 986,187 shares prior to the IPO.

During the nine months ended September 30, 2011, the Corporation recognized a realized loss of (\$1,780,612) on Niagara Dispensing and a loss of (\$293,519) on Associates Interactive LLC (Associates).

### **Net Change in Unrealized Appreciation of Investments**

The Corporation recorded a net increase in unrealized appreciation on investments of \$1,135,790 during the nine months ended September 30, 2012 and a net increase of \$3,696,431 during the nine months ended September 30, 2011.

The increase in unrealized appreciation for the nine months ended September 30, 2012 was comprised of the following items:

	<u>September 30, 2012</u>
Synacor, Inc. (Synacor)	\$1,153,250
Liazon Corporation (Liazon)	833,332
EmergingMed.com, Inc. (Emerging Med)	(337,546)
Ultra-Scan Corporation (Ultra-Scan)	<u>(513,246)</u>
<b>Total change in net unrealized appreciation during the nine months ended September 30, 2012</b>	<b>\$1,135,790</b>

Synacor, as a publicly traded stock, is marked to market at the end of each quarter. The stock had restrictions on its sale that expired on August 11, 2012. The Corporation valued its 852,362 shares of Synacor at a three day average bid price of \$7.58 for the nine months ended September 30, 2012.

Liazon completed another significant equity financing, with a higher valuation, during the second quarter of 2012 and it was led by a new non-strategic outside investor. The Corporation, therefore, in accordance with its valuation policy, increased the value of its holdings in Liazon based on this financing.

The Ultra-Scan investment was written down during the nine months ended September 30, 2012 after a review by the Corporation’s management of Ultra-Scan’s financials and an analysis of the liquidation preferences of senior securities. The Emerging Med investment was written down based on a financial analysis of the company.

The increase in unrealized appreciation for the nine months ended September 30, 2011 was comprised of the following items:

	<u>September 30, 2011</u>
Reclass Niagara Dispensing to realized loss	\$1,729,112
Synacor, Inc. (Synacor)	1,531,999
Reclass Associates to a realized loss	293,519
Liazon	<u>141,801</u>
<b>Total change in net unrealized appreciation during the nine months ended September 30, 2011</b>	<b>\$3,696,431</b>

---

## [\*\*Table of Contents\*\*](#)

The Corporation increased its value in Synacor based on an analysis of the financial and operational growth of the portfolio company.

In accordance with its valuation policy, the Corporation increased the value of its holdings in Liazon based on a significant equity financing during the second quarter of 2011 by a new non-strategic outside investor that had a higher valuation for this portfolio company.

All of these value adjustments resulted from a review by management using the guidance set forth by ASC 820 and the Corporation's established valuation policy.

### **Net Increase in Net Assets from Operations**

The Corporation accounts for its operations under GAAP for investment companies. The principal measure of its financial performance is "net increase in net assets from operations" on its consolidated statements of operations. For the nine months ended September 30, 2012, the net increase in net assets from operations was \$1,686,786 as compared to a net increase in net assets from operations of \$783,929 for the same nine month period in 2011. The increase for the nine months ended September 30, 2012 is a result of a \$767,920 net investment gain and a net realized and unrealized gain, net of tax, of \$918,869. The increase for the nine months ending September 30, 2011 was a result of a (\$265,761) net investment loss and a net realized and unrealized gain, net of tax, of \$1,049,690.

### **Liquidity and Capital Resources**

The Corporation's principal objective is to achieve capital appreciation. Therefore, a significant portion of the investment portfolio is structured to maximize the potential for capital appreciation and certain portfolio investments may be structured to provide little or no current yield in the form of dividends or interest payments.

As of September 30, 2012 the Corporation's total liquidity, consisting of cash and cash equivalents, was \$4,042,981.

During September 2011 and March 2012, the Corporation repaid a total of \$9,100,000 in existing SBA leverage and drew down \$3,000,000 in additional leverage during 2012. At September 30, 2012 the Corporation has \$3,900,000 in outstanding SBA leverage. In addition, during 2011, the Corporation contributed \$1,000,000 of additional regulatory capital to the Rand SBIC, Inc. subsidiary and was approved for \$8,000,000 in new SBA leverage, of which there is \$5,000,000 remaining as of September 30, 2012.

Management expects that cash and cash equivalents at September 30, 2012, coupled with the available SBA leverage and the scheduled interest and anticipated dividend payments on its portfolio investments, will be sufficient to meet the Corporation's cash needs throughout the next twelve months. The Corporation is evaluating potential exits from portfolio companies to increase the amount of liquidity available for new investments, operating activities and future SBA obligations.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The Corporation's investment activities contain elements of risk. The portion of the Corporation's investment portfolio consisting of equity and debt securities in private companies is subject to valuation risk. Because there is typically no public market for the equity and equity-linked debt securities in which it invests, the valuation of the equity interests in the portfolio is stated at "fair value" as determined in good faith by the management of the Corporation and submitted to the Board of Directors for approval.

---

## [\*\*Table of Contents\*\*](#)

This is in accordance with the Corporation's investment valuation policy. (The discussion of valuation policy contained in "Note 3.—Investments" in the consolidated financial statements contained in Item 1 of this report is hereby incorporated herein by reference.) In the absence of readily ascertainable market values, the estimated value of the Corporation's portfolio may differ significantly from the values that would be placed on the portfolio if a ready market for the investments existed. Any changes in valuation are recorded in the Corporation's consolidated statement of operations as "Net unrealized appreciation on investments."

At times the Corporation's portfolio may include marketable securities, including marketable securities traded in the over-the-counter market. In addition, there may be securities in the Corporation's portfolio for which no regular trading market exists. In order to realize the full value of a security, the market must trade in an orderly fashion or a willing purchaser must be available when a sale is to be made. Should an economic or other event occur that would not allow markets to trade in an orderly fashion, the Corporation may not be able to realize the fair value of its marketable investments or other investments in a timely manner.

As of September 30, 2012, the Corporation did not have any off-balance sheet arrangements or hedging or similar derivative financial instrument investments.

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

*Disclosure Controls and Procedures.* The Corporation maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that this information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. The Chief Executive Officer and the Chief Financial Officer carried out an evaluation of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures as of September 30, 2012. Based on the evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's controls and procedures were effective as of September 30, 2012.

*Changes in Internal Control over Financial Reporting.* There have been no significant changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents****PART II.  
OTHER INFORMATION****Item 1. Legal Proceedings**

None

**Item 1A. Risk Factors**

See Part I, Item 1A, "Risk Factors," of the 2011 Annual Report on Form 10-K for the year ended December 31, 2011. The Risk Factors from our 2011 report on Form 10-K remains applicable with the exception of the following additions:

**Fluctuations of Quarterly Results**

The Corporation's quarterly operating results could fluctuate as a result of a number of factors. These factors include, among others, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which portfolio companies encounter competition in their markets and general economic conditions and the market value of publicly traded securities. As a result of these factors, results for any one quarter should not be relied upon as being indicative of performance in future quarters.

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

Period	Total number of shares purchased (1)	Average price paid per share (2)	Total number of shares purchased as part of publicly announced plan (3)	Maximum number of shares that may yet be purchased under the share repurchase program
7/1/2012 - 7/31/2012	—	—	—	340,946
8/1/2012 - 8/31/2012	—	—	—	340,946
9/1/2012 - 9/30/2012	60,942	\$ 2.58	60,942	280,004

- (1) The total number of shares purchased was 60,942 for the third quarter of 2012. All transactions were made in the open market.  
(2) The average price paid per share is calculated on a settlement basis and includes commission  
(3) On October 28, 2011 the Board of Directors authorized the repurchase of up to 340,946 shares of the Corporation's outstanding common stock on the open market through October 28, 2012 at prices that are no greater than current net asset value.

**Item 3. Defaults upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

None

**Item 5. Other Information**

None

---

## [Table of Contents](#)

### **Item 6. Exhibits**

#### **(a) Exhibits**

The following exhibits are filed with this report or are incorporated herein by reference to a prior filing, in accordance with Rule 12b-32 under the Securities Exchange Act of 1934.

- (3)(i) Certificate of Incorporation of the Corporation, incorporated by reference to Exhibit (a) (1) of Form N-2 filed with the Securities Exchange Commission on April 22, 1997. (File No. 814-00235).
- (3)(ii) By-laws of the Corporation incorporated by reference to Exhibit (b) of Form N-2 filed with the Securities Exchange Commission on April 22, 1997. (File No. 814-00235).
- (4) Specimen certificate of common stock certificate, incorporated by reference to Exhibit (b) of Form N-2 filed with the Securities Exchange Commission on April 22, 1997. (File No. 814-00235).
- (31.1) Certification of the Chief Executive Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended, filed herewith
- (31.2) Certification of Chief Financial Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended, filed herewith
- (32.1) Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – Rand Capital Corporation – furnished herewith

---

[Table of Contents](#)

**Signatures**

**Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.**

Dated: November 1, 2012

RAND CAPITAL CORPORATION

By: /s/ Allen F. Grum  
Allen F. Grum, President

By: /s/ Daniel P. Penberthy  
Daniel P. Penberthy, Treasurer

**EXHIBIT 31.1**

**CERTIFICATION**

**Chief Executive Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange  
Act of 1934, as amended**

I, Allen F. Grum, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rand Capital Corporation and subsidiaries;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 1, 2012

---

*/s/ Allen F. Grum*  
Allen F. Grum, President  
(Chief Executive Officer of Rand Capital Corporation)

**EXHIBIT 31.2**

**CERTIFICATION**

**Chief Financial Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange  
Act of 1934, as amended**

I, Daniel P. Penberthy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rand Capital Corporation and subsidiaries;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 1, 2012

/s/ Daniel P. Penberthy

---

Daniel P. Penberthy, Treasurer  
(Chief Financial Officer of Rand Capital  
Corporation)

**EXHIBIT 32.1**

**CERTIFICATION**

**Pursuant to 18 U.S.C Section 1350 as Adopted Pursuant to Section 906  
Of the Sarbanes-Oxley Act of 2002**

Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Rand Capital Corporation (the "Company"), does hereby certify, to such officer's knowledge, that:

The Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (the Form10-Q) of the Company fully complies with the requirement of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 1, 2012

/s/ Allen F. Grum

---

Allen F. Grum, President  
(Chief Executive Officer)

Dated: November 1, 2012

/s/ Daniel P. Penberthy

---

Daniel P. Penberthy, Treasurer  
(Chief Financial Officer)