

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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

For the quarterly period ended September 30, 2001

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: 811-1825

**Rand Capital Corporation**

(Exact Name of Registrant as specified in its Charter)

New York  
(State of Jurisdiction of Incorporation  
or organization)

16-0961359  
(IRS Employer  
Identification No.)

**2200 Rand Building, Buffalo, NY 14203**

(Address of Principal executive offices) (Zip Code)

**(716) 853-0802**

(Registrant's Telephone No. including Area Code)

Indicate by check mark whether the registrant has (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act 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

Number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date (October 31, 2001): **5,763,034**

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

**PART I - FINANCIAL INFORMATION**

- Item 1. Financial Statements  
Condensed Statements of Financial Position as of September 30, 2001 and December 31, 2000  
Condensed Statements of Operations for the three-months and nine-months ended September 30, 2001 and September 30, 2000  
Condensed Statements of Cash Flows for the nine-months ended September 30, 2001 and September 30, 2000  
Statements of changes in Net Assets for the three-months and nine-months ended September 30, 2001 and September 30, 2000  
Portfolio of Investments as of September 30, 2001  
Notes to Condensed Financial Statements
- Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Results of Operations  
Liquidity and Capital Resources
- Item 3. Quantitative and Qualitative Disclosures about Market Risk

**PART II - OTHER INFORMATION**

- Item 1. Legal Proceedings

- Item 2. Changes in Securities and Use of Proceeds
- Item 3. Defaults upon senior securities
- Item 4. Submission of matters to a vote of Security Holders
- Item 5. Other Information
- Item 6. Exhibits and Reports on Form 8-K

**RAND CAPITAL CORPORATION**  
**CONDENSED STATEMENTS OF FINANCIAL POSITION**  
**AS OF SEPTEMBER 30, 2001 AND DECEMBER 31, 2000**

**ASSETS**

	September 30, 2001 (Unaudited)	December 31, 2000
Cash and cash equivalents	\$ 714,326	\$ 304,152
Investment portfolio at original cost basis	5,906,765	6,159,330
Adjustment for unrealized appreciation	1,745,483	974,597
Investments at Directors' valuation	7,652,248	7,133,927
Interest receivable (net of allowance of \$58,101 at September 30, 2001 and \$21,729 at December 31, 2000)	151,293	136,780
Deferred tax asset	439,551	660,790
Other assets	185,876	206,235
<b>TOTAL ASSETS</b>	<b>\$ 9,143,294</b>	<b>\$ 8,441,884</b>

**LIABILITIES AND STOCKHOLDERS EQUITY (NET ASSETS)**

**LIABILITIES:**

Income taxes payable	\$ 11,530	\$ 1,530
Accounts payable and accrued expenses	41,875	54,657
<b>Total Liabilities</b>	<b>53,405</b>	<b>56,187</b>

**STOCKHOLDERS' EQUITY (NET ASSETS)**

Common stock, \$.10 par - shares authorized 10,000,000; issued and outstanding 5,763,034 at September 30, 2001 and 5,748,034 at December 31, 2000	576,304	574,804
Capital in excess of par value	6,973,454	6,943,079
Undistributed net investment (loss)	(2,677,027)	(2,065,672)
Undistributed net realized gain on investments	3,061,258	2,400,233
Net unrealized appreciation of investments	1,155,900	533,253
<b>Net assets</b>	<b>9,089,889</b>	<b>8,385,697</b>

<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 9,143,294</b>	<b>\$ 8,441,884</b>
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Shares outstanding	5,763,034	5,748,034
Net asset value per outstanding share	\$1.58	\$1.46

**See notes to condensed financial statements**

**RAND CAPITAL CORPORATION**  
**CONDENSED STATEMENTS OF OPERATIONS**  
**FOR THE QUARTER AND NINE MONTHS**  
**ENDED SEPTEMBER 30, 2001 AND SEPTEMBER 30, 2000**  
**(UNAUDITED)**

	Three-months ended September 30, 2001	Three-months ended September 30, 2000	Nine-months ended September 30, 2001	Nine-months ended September 30, 2000	
<b>Investment income:</b>					
Interest from portfolio companies		\$ 25,769	\$ 42,689	\$ 88,298	\$ 122,396
Interest from other investments		1,209	19,086	6,931	63,149
Other income		600	594	8,698	594
	27,578	62,368	103,927	186,139	
<b>Expenses:</b>					
Salaries	59,176	56,500	247,395	206,304	
Employee benefits	12,054	11,395	53,248	56,219	
Directors' fees	10,250	4,500	19,750	22,500	
Legal fees	(10,000)	13,026	8,981	27,406	
Professional fees	7,900	6,100	24,110	21,728	
Shareholders and office	17,509	16,412	54,594	48,189	
Insurance	6,750	7,200	20,250	21,710	
Corporate development	4,627	5,085	15,552	13,937	
Other operating expenses	53,464	24,299	182,414	68,746	
	161,730	144,517	626,294	486,739	
<b>Investment (loss) before income taxes</b>		(134,152)	(82,149)	(522,367)	(300,600)
Income tax provision	2,580	3,010	15,987	9,008	
Deferred income tax (expenses)	73,000	0	73,000	0	
<b>Investment (loss) - net</b>	(209,732)	(85,159)	(611,354)	(309,608)	
<b>Realized and unrealized gain (loss) on investments:</b>					
Net gain (loss) on sales and dispositions	660,332	(8,551)	661,025	(108,551)	
<b>Net realized gain (loss)</b>	660,332	(8,551)	661,025	(108,551)	
<b>Unrealized appreciation on investments:</b>					
Beginning of period	2,065,764	1,077,262	974,597	(863,197)	
End of period	1,745,483	1,197,225	1,745,483	1,197,225	
Increase (Decrease) in unrealized appreciation before income taxes	(320,281)	119,963	770,886	2,060,422	
Deferred income tax expense	0	0	148,239	600,000	
<b>Net (decrease) increase in unrealized appreciation</b>	(320,281)	119,963	622,647	1,460,422	
<b>Net realized and unrealized gain on investments</b>		340,051	111,412	1,283,672	1,351,871
<b>Net increase (decrease) in net assets from operations</b>	\$ 130,319	\$ (26,253)	\$ 672,318	\$ 1,042,263	
<b>Weighted average shares outstanding</b>		5,763,034	5,723,034	5,762,045	5,721,715
<b>Basic and diluted net increase (decrease) in net assets from operations per share</b>		\$0.02	(\$0.00)	\$0.12	\$0.18

See notes to condensed financial statements

**RAND CAPITAL CORPORATION**  
**CONDENSED STATEMENTS OF CASH FLOWWS**  
**FOR THE NINE-MONTHS ENDED SEPTEMBER 30, 2001 AND SEPTEMBER 30, 2000**  
**(UNAUDITED)**

	For the nine-months ended September 30, 2001	For the nine-months ended September 30, 2000
<b>Cash Flows from Operating Activities:</b>		
Net increase in net assets from operations	\$672,318	\$1,042,263
<b>Adjustments to reconcile net increase in net assets to net cash used in operating activities:</b>		
Depreciation and amortization	9,750	10,000
Interest receivable reserve	36,372	0
(Increase) in unrealized appreciation of investments, net of deferred income tax	(622,647)	(1,460,422)
Decrease in deferred tax assets	73,000	0
Net realized (gain) loss on portfolio of investments	(661,025)	108,551
Changes in operating assets and liabilities:		
(Increase) in interest receivable	(50,885)	(43,212)
(Increase) decrease in other assets	10,609	(27,692)
Increase (decrease) in accounts payable and other accrued liabilities	(2,782)	10,869
Total adjustments	(1,207,608)	(1,401,906)
<b>Net cash (used in) operating activities</b>	<b>(535,290)</b>	<b>(359,643)</b>
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sale of portfolio investments	1,084,054	85,813
Proceeds from loan repayments	0	420,000
New portfolio investments	(170,465)	(1,263,537)
<b>Net cash provided by (used in) investing Activities</b>	<b>913,589</b>	<b>(757,724)</b>
<b>Cash Flows from financing Activities:</b>		
Proceeds from issuance of stock	31,875	57,700
<b>Net cash provided by financing activities</b>	<b>31,875</b>	<b>57,700</b>
<b>Net Increase (decrease) in cash and cash equivalents</b>	<b>410,174</b>	<b>(1,059,667)</b>
Cash and cash equivalents at beginning of period	304,152	1,139,708
<b>Cash and cash equivalents at end of period</b>	<b>\$714,326</b>	<b>\$80,041</b>

See notes to condensed financial statements

**RAND CAPITAL CORPORATION**  
**CONDENSED STATEMENTS OF CHANGES IN NET ASSETS FOR THE QUARTER AND**  
**NINE-MONTHS ENDED SEPTEMBER 30, 2001 AND SEPTEMBER 30, 2000**  
**(UNAUDITED)**

	Three-months ended September 30, 2001	Three-months ended September 30, 2000	Nine-months ended September 30, 2001	Nine-months ended September 30, 2000
<b>Net assets at beginning of period</b>	\$8,959,570	\$8,640,702	\$8,385,697	\$7,604,743
Operations:				
Net investment loss	(209,732)	(85,159)	(611,354)	(309,608)
Net realized gain (loss) on investments	660,332	(8,551)	661,025	(108,551)
Net (decrease) increase in unrealized				

appreciation of investments	(320,281)	119,693	622,647	1,460,422
Other	0	271	(1)	0
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Net increase in net assets from operations	130,319	26,254	672,317	1,042,263
Net proceeds of private offerings	0	37,750	31,875	57,700
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<b>Net assets at end of period</b>	<b>\$9,089,889</b>	<b>\$8,704,706</b>	<b>\$9,089,889</b>	<b>\$8,704,706</b>
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See notes to condensed financial statements

**RAND CAPITAL CORPORATION**  
**PORTFOLIO OF INVESTMENTS**  
**AS OF SEPTEMBER 30, 2001**  
**(UNAUDITED)**

Company	Type of Investment Acquired	June 30, 2001		Valuation	
		Date	Cost		
		(\$)	(\$)		
ADIC (NASDAQ:ADIC)* Redmond, WA. Manufactures data storage systems and specialized storage management software. Acquired Pathlight Technology 5/11/01. www.adic.com	391,265 shares Common Stock. Options to purchase 54,786 shares. Valued at \$10 per share.	5/11/01	\$977,239	\$4,376,878	
American Tactile, Corp. Medina, NY. Develops equipment and systems to produce signage. www.americantactile.com	Convertible Debentures at 8% due June 2000 and April 2001 with detachable warrants	6/23/95	150,000	25,000	
ARIA Wireless Systems, Inc. (OTC:AWSI)* Buffalo, NY. Markets wireless radio transmission communication equipment. www.aria-glb.com	Common Stock - 488,000 shares. \$105,840 Demand Notes at 15%	5/23/97	543,840	9,760	
BioWorks, Inc. Geneva, NY. Develops and manufactures biological alternatives to chemical pesticides. www.bioworksbiocontrol.com	Series A Convertible Preferred Stock - 32,000 shares.	11/6/95	56,000	28,000	
Clearview Cable TV, Inc. Providence, NJ. Cable Television Operator.	New Common Stock - 400 shares.	2/23/96	55,541	28,000	
Contract Staffing, Inc. Buffalo, NY. PEO providing human resource administration for small businesses. www.contract-staffing.com	Series A 8% Cumulative Preferred Stock -10,000 shares.	11/8/99	100,000	100,000	
DataView, LLC. Mt. Kisco, NY. Designs, develops and markets browser based software for investment professionals. www.marketgauge.com	5.5% Membership Interest	10/1/98	310,357	343,357	
Fertility Acoustics, Inc. Buffalo, NY. Developer of proprietary methods to diagnose onset of ovulation.	Common Stock - 848,736 shares	10/1/97	87,440	87,440	
G-TEC Natural Gas Systems	41.67% Class A Membership	8/31/99	300,000	300,000	

Buffalo, NY. Manufactures and distributes systems that allow natural gas to be used as an alternative fuel to gases. www.gas-tec.com	Interest. 8% Cumulative Dividend				
HCI Systems. Kennebunk, ME. Facilities management software solution. www.hcisystems.com	Series B Preferred Stock - 67,000 shares. 5% Cumulative Dividend	12/15/99	100,500	100,500	
INRAD, Inc. OTC:INRD.OB)* Northvale, NJ. Develops and manufactures products for laser photonics industry. www.inrad.com	Convertible Series B Preferred Stock - 100 shares. 10% Dividend Common Stock - 2,000 shares	10/31/00	105,000	102,640	
MemberWare Technologies, Inc. Pittsford, NY. Internet company engaged in web related consulting services. www.memberware.com	Promissory Note at Prime Rate + 4.5% due September 2004. Common Stock - 40,000 shares. 34,000 warrants for shares of stock	9/16/99	100,000	150,000	
MINRAD, Inc. Buffalo, NY. Developer of laser guided surgical devices.	595,506 Common Shares 53,628 Preferred Shares	8/4/97	874,030	1,111,000	
Ultra-Scan Corporation Amherst, NY. Ultrasonic finger print technology. www.ultra-scan.com	Common Shares - 49,290 \$100,000 Bridge Loan at 12%	12/11/92	402,586	469,675	
UStec, Inc. Victor, NY. Manufactures and markets digital wiring systems for residential new home construction. www.ustecnet.com	Promissory Note at 12% due January 2003. Common Stock - 50,000 shares. 2,500 warrants for common shares	12/17/98	100,500	150,000	
Vanguard Modular Building Systems. Philadelphia, PA. Leases and sells high-end modular space solutions. www.vanguardmodular.com	Preferred Units - 2,673 Units with warrants. 14% Interest Rate	12/16/99	270,000	270,000	
Other Investments			1,310,887	(2)	
<b>Total Portfolio Investments</b>			<b>\$5,906,765</b>	<b>\$7,652,248</b>	

\*Publicly owned company.

Note: Restricted securities, including securities of publicly-owned companies which are subject to restrictions on resale, are valued at fair market value as determined by the Board of Directors. Fair value is considered to be the amount which the Corporation may reasonably expect to receive for portfolio securities if such securities were 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. Among the factors considered by the Board of Directors 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..

See notes to condensed financial statements

**RAND CAPITAL CORPORATION**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**  
**FOR THE QUARTER AND NINE-MONTHS ENDED SEPTEMBER 30, 2001 AND 2000**

## (UNAUDITED)

### 1. Basis of Presentation

In Management's opinion, the accompanying condensed financial statements include all adjustments necessary for a fair presentation of 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 accounting principles generally accepted in the United States of America, 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 ended September 30, 2001 are not necessarily indicative of the results for the full year.

It is suggested that these statements be read in conjunction with the financial statements and the notes included in the Corporation's Annual Report for the year ended December 31, 2000. Information contained in this filing should also be reviewed in conjunction with Rand Capital Corporation's related filings with the Securities & Exchange Commission ("SEC") during the period of time covered by this filing. These filings include, but are not limited to the following:

N-30-B2	Quarterly & Annual Reports to Shareholders
N-54A	Election to Adopt Business Development Company status
NSAR-A	Semi-Annual filing as closed end investment company
NSAR-B	Semi-Annual filing as closed end investment company
DEF-14A	Definitive Proxy Statement submitted to shareholders
10-Q	Quarterly Financial Reporting for quarter ended June 30, 2001

### 2. Summary of Significant Accounting Policies

#### Nature of Business

Rand Capital Corporation ("Rand" or "Corporation") is a venture capital investment company operating as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"). A BDC is a specialized type of investment company under the 1940 Act. A BDC must be primarily engaged in the business of furnishing capital and managerial expertise to companies that do not have ready access to capital through conventional financial channels; such companies are termed "eligible portfolio companies". Rand, as a BDC, may invest in other securities, however such investments may not exceed 30% of Rand's total asset value at the time of such investment.

On July 20, 2001, Rand's shareholders approved the proposal to allow Rand to adopt BDC status. Following this authorization by the Shareholders, and approval by Rand's Board of Directors, Rand filed its BDC election with the SEC (Form N-54A) on August 16, 2001. Prior to Rand's election as a BDC, Rand operated as a closed-end, diversified, management company under the 1940 Act.

Rand was founded in 1969 and its stock has traded publicly since 1971. Rand's stock is currently listed on the NASDAQ Small Cap Market under the symbol "RAND". The company is headquartered in Buffalo, New York. Rand operates as an internally managed investment company whereby its officers and employees conduct its operations under the general supervision of its Board of Directors.

#### Net Asset Value

Rand accounts for its operations under accounting principles generally accepted in the United States of America for investment companies. On this basis, the principal measure of its financial performance is provided in its Condensed Statements of Operations under the caption "Net Increase (decrease) in net assets from operations" which is composed of the following:

"Investment loss - net" (from operations) which is the difference between the Corporation's income from interest, dividends and fees and its operating expenses and taxes.

"Net realized (loss) gain" which is the difference between the proceeds received from dispositions of portfolio securities and their stated cost.

"Net increase (decrease) in unrealized appreciation" which is the net change in the fair value of Rand's investment portfolio, net of any increase (decrease) in deferred income taxes that would become payable if the unrealized appreciation were realized through the sale or other disposition of the investment portfolio.

Rand's net assets are calculated based on the net assets at the end of the period, after the effect of the items included in the calculation of the net increase or decrease in net assets from operations. The net asset value per share is then determined based on the common shares outstanding. Rand has no preferred stock, or stock options outstanding that would be potential common shares, thus reported per share net asset value and diluted net asset value per share results would be the same.

## **Income Taxes**

Rand has not elected pass-through tax treatment as a regulated investment company under Subchapter M of the Internal Revenue Code for Income tax purposes. Therefore, Rand is taxed as a corporation under regulation C.

The tax effect of the major temporary difference and carry-forwards that give rise to the Corporation's net deferred tax assets at September 30, 2001 and December 31, 2000 are as follows:

	<u>September 30, 2001</u>	<u>December 31, 2000</u>
Operations	\$ (29,209)	\$ (51,697)
Investments	(784,256)	(389,254)
Net operating loss carry-forwards	1,253,016	1,086,443
Capital loss carry-forward	<u>0</u>	183,948
Subtotal	\$ 439,551	\$ 829,440
Valuation allowance	<u>0</u>	(168,650)
Deferred tax assets, net	\$ 439,551	\$ 660,790

At September 30, 2001 and December 31, 2000, the Corporation had a federal and state net operating loss carry-forward of approximately \$3,102,000 and \$2,720,000, respectively, which expire commencing in 2007.

## **Stockholders' Equity**

On July 20, 2001 Rand's shareholders approved the proposal to establish the 2001 Stock Option Plans including the "Employee Plan" which provides for grant of stock options for up to an aggregate of 200,000 shares to the Corporation's key employees and officers; and the Non-Employee Director Stock Option Plan, or "Director Plan" which provides for up to an aggregate of 100,000 shares to Rand's outside directors. The Director Plan also will require an exemptive order by the SEC prior to any options being issued through the plan. Both Plans are fully described in the information presented under the caption "Proposal to Approve Stock Option Plans for the Corporation" in the Company's definitive Proxy Statement as filed with the SEC on June 8, 2001, which information is incorporated herein by reference.

No stock options have been granted under the Employee Plan or the Director Plan through September 30, 2001.

Rand sold shares of its common stock through a private stock offering with two officers of the Corporation for a total of 15,000 shares in January 2001; 15,000 shares in January 2000; and 25,000 shares in September 2000; the shares were priced at \$2.12; \$1.33 and \$1.51 respectively; total proceeds to the Corporation were \$31,875 in 2001 and \$57,700 in 2000.

## **Use of Estimates**



The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 periods. Actual results could differ from those estimates.

### Significant Events

On May 11, 2001, one of Rand's privately held portfolio investments, Pathlight Technologies Inc. was acquired by Advanced Digital Information Corporation (NASDAQ:ADIC). Rand held an estimated 5% ownership of Pathlight (cost basis of approximately \$1.2 million) and in exchange for the Pathlight investment, Rand has received 461,265 shares of ADIC common stock and options to purchase 54,786 shares for an equivalent total of 516,051 shares. In addition, there are 13,683 shares remaining in escrow pending release subject to certain conditions. The ADIC shares received by Rand are subject to sale under Rule 145 restrictions and became tradable August 20, 2001.

During August 2001 Rand sold a total of 70,000 shares at an average price of \$12.41 (range \$12.01 - \$12.72). Rand's average cost basis for the ADIC securities is \$2.12. Rand's remaining ADIC holdings have been valued at \$4.4 million in its September 30, 2001 investment portfolio.

Following the end of the quarter, an additional 229,000 shares were sold in October 2001 at an average price of \$13.52 (range of \$10.10 - \$15.50). At October 31, 2001, Rand continues to hold approximately 217,000 shares of ADIC (including the 54,786 shares held via options).

## Item 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FORWARD LOOKING STATEMENTS

Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this document 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 Company from time to time, and those statements may be included in documents that are filed with the Securities and Exchange Commission. Such 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 Company'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 Company's portfolio companies operate, the state of the securities markets in which the securities of the Company's portfolio company 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 "Certain Risk Factors" below.

### Financial Condition

Rand's total assets and net assets at September 30, 2001 and December 31, 2000 were as follows:

	<u>September 30, 2001</u>	<u>December 31, 2000</u>
Total assets	\$9,143,294	\$8,441,884
Net assets	9,089,889	8,385,697
Net asset value per share	\$1.58	\$1.46

Primarily contributing to the \$701,000 increase in total assets and the \$704,000 increase in net assets was the net change in valuations of various portfolio companies, the sale of ADIC securities for a gain, and the related tax effects of these transactions during the nine-month period.

Rand's financial condition is dependent on the success of its investments. Rand has invested a substantial portion of its assets in early stage or start-up companies. These private businesses tend to be thinly capitalized, unproven, small companies that may lack management depth and history of operations. A summary of Rand's investment portfolio is as follows:

	<u>September 30, 2001</u>	<u>December 31, 2000</u>
Investments, at cost	\$5,906,765	\$6,159,330
Unrealized appreciation	1,745,483	974,597
Investments at fair value	<u>\$7,652,248</u>	<u>\$7,133,927</u>

The increase in the unrealized appreciation of the investments is primarily attributable to the net effect of portfolio valuation adjustments to the following portfolio companies during the nine-month period ended September 30, 2001: Pathlight Technology/Advanced Digital Information Corporation ("ADIC"), \$2.4 million; BNKR.com, (\$0.4 million); Fertility Acoustics, Inc., (\$1.1 million), Aria Wireless Systems, Inc., (\$0.1 million), and Platform Technology Holdings, LLC, (\$0.1 million).

Rand's total investments at fair value approximated 84% of net assets at September 30, 2001 and 85% of net assets at December 31, 2000. Of Rand's portfolio investments, one investment, Pathlight/ADIC, valued at \$4.4 million at September 30, 2001 and \$2.0 million at December 31, 2000, approximated 48% of net assets at September 30, 2001 and 24% of net assets at December 31, 2000.

During the nine-month period ending September 30, 2001 Rand's investment activities included the sale of 70,000 shares of ADIC in August 2001, (with a realized gain of approximately \$720,000). Other investing activity during the period included the sale of Rand's investments in Motorola and Texaco preferred stocks, valued at \$0.2 million at December 31, 2000; New investments included a \$100,000 bridge loan to Ultra-Scan and a \$55,000 follow-on investment in Platform Technology Holdings (subsequently written off).

The effect of the portfolio valuation changes, net operating losses for the period, and the realized gain from the sale of ADIC securities, resulted in a net change in the deferred tax asset from \$660,790 at December 31, 2000 to \$439,551 at September 30, 2001. In addition, during the quarter ended June 30, 2001, Rand reversed the \$168,650 tax valuation allowance previously recorded, reflecting the increased likelihood of its utilization given the Pathlight/ADIC transaction.

## **Results of Operations**

On May 11, 2001, one of Rand's privately held portfolio investments, Pathlight Technologies Inc. was acquired by Advanced Digital Information Corporation (NASDAQ:ADIC). In exchange for Rand's estimated 5% ownership of Pathlight (cost basis of approximately \$1.2 million), Rand has received 461,265 shares of ADIC common stock and options to purchase 54,786 shares. The ADIC shares received by Rand are subject to sale under Rule 145 restrictions and became tradable August 20, 2001.

During August 2001 Rand sold a total of 70,000 shares at a range of \$12.10 - \$12.72. Rand's average cost basis for the ADIC securities is \$2.12. Rand's remaining ADIC holdings have been valued at \$4.4 million in its September 30, 2001 investment portfolio.

Following the end of the quarter, an additional 229,000 shares were sold in October 2001 at a range of \$10.10 - \$15.50. At October 31, 2001, Rand is holding approximately 217,000 shares of ADIC.

## **Investment Income and Expenses:**

Total investment income for the three-months ended September 30, 2001 and 2000 was \$27,578 and \$62,368, respectively, of which \$25,769 (93%) and \$42,689 (68%) consisted of interest from portfolio companies during the period. The remaining income consisted of interest on other temporary short-term investments and cash balances. For the nine-months ended September 30, 2001 and 2000, the total investment income was \$103,927 and \$186,139, respectively, of which \$88,298 (85%) and \$122,396 (66%) consisted of interest from portfolio companies during the period. The remaining income consisted of interest on short-term investments, cash balances, and other income. The total investment income for the three and nine-months ended September 30, 2000 was higher mainly due to higher idle cash balances and the related interest income earnings, in addition to the shutdown of portfolio companies affecting the portfolio's interest earning investments. Due to the lower cash balances in 2001, the Corporation was not materially affected by decline in interest rates during the preceding 12 months.

Expenses for the three-months ended September 30, 2001 and 2000 were \$161,730 and \$144,517, respectively. Expenses for the nine-month period ended September 30, 2001 and September 30, 2000 were \$626,294 and \$486,739, respectively. A majority of the Rand's expenses consist of employee compensation, shareholder and office expenses, expenses related to identifying and reviewing investment opportunities and professional fees. A major increase in expenses during the three-month and nine-month periods in 2001 directly resulted from costs (consulting and advisory fees) incurred for restructuring the Corporation to a Business Development Company ("BDC"), and research into stock option plans and other corporate matters. These costs have been included in other operating expenses and total \$71,000 for the nine-months ended September 30, 2001. Also increasing expenses during 2001 were the establishment of allowances related to the write-off of certain portfolio related receivables totaling \$36,371 for the nine-months ended September 30, 2001.

Net investment losses from operations were \$209,732 and \$85,159 for the three-months ended September 30, 2001 and 2000, respectively. For the nine-months ended September 30, 2001 and 2000, net investment losses were \$611,354 and \$309,608, respectively. The combined effect of the shutdown of the operations of several Rand portfolio companies, the loss of their related dividend/interest payments, and the increased costs related to Rand's annual proxy filings have resulted in increased operating losses in 2001 as compared to 2000.

#### **Net Realized Gains and Losses on Portfolio of Investments:**

During the three-months ended September 30, 2001, Rand sold 70,000 shares of its ADIC holdings, generating a realized gain of approximately \$720,000. Also during the quarter, ADIC settled its patent litigation with Pathlight, which resulted in a release from escrow of an additional 26,417 ADIC shares to Rand, and a forfeiture of 28,313 shares previously held in escrow (with an average cost basis of \$60,024). During the same period in 2000 Rand had realized a loss of \$8,551 from the sale of certain preferred securities held in the portfolio.

#### **Net Increase (decrease) in Net Assets from Operations:**

Rand accounts for its operations under accounting principles generally accepted in the United States of America for investment companies. On this basis, the principal measure of its financial performance is "net increase (decrease) in net assets from operations" on its condensed statements of operations. For the three-months ended September 30, 2001, the net increase in net assets from operations was \$130,319 as compared to a net decrease in net assets from operation of (\$26,253) for the three-months ended September 30, 2000. The increase in net realized and unrealized gain on investments during the third quarter is primarily attributable to the sale of ADIC securities at a gain. The year-to-date increase in assets is attributable to net effect of portfolio valuation adjustments to the following portfolio companies during the nine-month period ended September 30, 2001: Pathlight Technology, Inc./ADIC, \$2.4 million; BNKR.com, (\$.4 million); Fertility Acoustics, Inc., (\$1.1 million); Aria Wireless Systems, Inc., (\$0.1 million); and Platform Technology Holdings, LLC (\$0.1 million).

For the nine-months ended September 30, 2001 and 2000, the net increase in net assets from operations was \$672,318 and \$1,042,263, respectively.

#### **Liquidity and Capital Resources**

Rand'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 Rand portfolio investments may be structured to provide little or no current yield in the form of dividends or interest payments. Rand does earn interest income on idle cash balances. Rand has historically relied on and continues to rely to a large extent upon proceeds from sales of investments rather than investment income to defray a significant portion of its operating expenses. Because such sales cannot be predicted with certainty, Rand attempts to maintain adequate working capital necessary for short-term needs.

On September 30, 2001, Rand was holding approximately \$714,000 in cash (primarily generated from the sale of the ADIC securities in August 2001) compared to a total of approximately \$512,000 (\$304,000 cash and \$208,000 in marketable preferred equities) at December 31, 2000. Through August, Rand had a decrease in liquidity, which resulted in decreased interest earnings on idle cash balances.

During the nine-month period ended September 30, 2001, Rand has sold 70,000 shares of its ADIC holdings and also sold its investments in Motorola and Texaco preferred stocks. New investments included an Ultra-scan bridge loan of \$100,000 and a \$55,000 follow-on investment in Platform Technology Holdings.

During the year, Rand also adjusted the valuations for several portfolio investments during the period, which included; ARIA Wireless Systems, Inc., Pathlight Technology, Inc./ADIC, Fertility Acoustics, Inc., BNKR.com; INRAD, Inc.

These were non-cash adjustments, included as adjustments in the condensed statements of cash flows.

During the nine-month period ended September 30, 2000, Rand made new investments in BNKR.com, \$250,000 and TSS-Transnet, \$250,000 (both were subsequently written off); and made a follow-on investment in Pathlight Technology, Inc., \$750,000. The InfoMiners.com \$420,000 bridge loan was also repaid. During this period, valuation changes were made to Fertility Acoustics, Inc. and Pathlight Technology, Inc. However, these are non-cash adjustments.

### **Certain Risk Factors**

#### **Investing in Rand's Stock is Highly Speculative and an Investor Could Lose Some or All of the Amount Invested**

The value of Rand's common stock may decline and may be affected by numerous market conditions, which could result in the loss of some or all of the amount invested in Rand's shares. The securities markets frequently experience extreme price and volume fluctuations which affect market prices for securities of companies generally, and technology and very small capitalization companies in particular. General economic conditions, and general conditions in the Internet and information technology, life sciences, material sciences and other high technology industries, will also affect the Rand's stock price. The recent decimalization of the stock exchanges, particularly NASDAQ, is a new risk factor that may decrease liquidity of smaller capitalization issues such as the Company's own common stock and that of its publicly traded holdings. In addition, the terrorist acts of September 11, 2001 in the United States also are a new risk factor, which may affect the operations of both Rand and its portfolio companies.

#### **Investing in Rand's Shares May be Inappropriate for the Investor's Risk Tolerance**

Rand's investments, in accordance with its investment objective and principal strategies, result in a far above average amount of risk and volatility and may well result in loss of principal. Rand's investments in portfolio companies are highly speculative and aggressive and, therefore, an investment in its shares may not be suitable for investors for whom such risk is inappropriate.

Rand may face competition in its investing activities from private venture capital funds, investment affiliates of large industrial, technology, service and financial companies, small business investment companies, wealthy individuals and foreign investors. As a regulated Business Development Company ("BDC"), the Company is required to disclose quarterly the name and business description of portfolio companies and value of any portfolio securities. Most of Rand's competitors are not subject to this disclosure requirement. Rand's obligation to disclose this information could hinder its ability to invest in certain portfolio companies. Additionally, other regulations, current and future, may make Rand less attractive as a potential investor to a given portfolio company than a private venture.

#### **Rand Operates in a Regulated Environment**

Rand is subject to substantive SEC regulations as a BDC. Securities and tax laws and regulations governing the Rand's activities may change in ways adverse to Rand's and its shareholders' interests, and interpretations of such laws and regulations may change with unpredictable consequences. Any change in the laws or regulations that govern Rand's business could have an adverse impact on Rand or its operations.

#### **Rand is Dependent Upon Key Management Personnel for Future Success**

Rand is dependent for the selection, structuring, closing and monitoring of its investments on the diligence and skill of its senior management. The future success of Rand depends to a significant extent on the continued service and coordination of its senior management team. The departure of any of the executive officers or key employees could materially adversely affect Rand's ability to implement its business strategy. Rand does not maintain key man life insurance on any of its officers or employees.

#### **Investment in Small, Private Companies**

There are significant risks inherent in Rand's venture capital business. Rand has invested a substantial portion of its assets in early stage or start-up companies. These private businesses tend to be thinly capitalized, unproven, small companies with risky technologies that lack management depth and have not attained profitability or have no history of operations. Because of the speculative nature and the lack of a public market for these investments, there is significantly greater risk of loss than is the case with traditional investment securities. Rand expects that some of its venture capital investments will be a complete loss or will be unprofitable and that some will appear to be likely to become successful but never realize their potential. Rand has been risk seeking rather than risk averse in its approach to venture capital and other investments. Neither Rand's investments nor an investment in Rand is intended to constitute a

balanced investment program. Rand has in the past relied, and continues to rely to a large extent, upon proceeds from sales of investments rather than investment income to defray a significant portion of its operating expenses. Such sales are unpredictable and may not occur. The terrorist acts in the United States of September 11, 2001 are the type of events that could severely impact a small company that does not have as many resources to ride out market downturns and would need immediate investment capital that might be temporarily unavailable.

### **Illiquidity of Portfolio Investments**

Most of the investments of Rand are or will be either equity securities acquired directly from small companies or below investment grade subordinated debt securities. The Company's portfolio of equity securities are and will usually be subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of the Company's portfolio may adversely affect the ability of the Company to dispose of such securities at times when it may be advantageous for the Company to liquidate such investments.

Even if the Rand's portfolio companies are able to develop commercially viable products, the market for new products and services is highly competitive and rapidly changing. Commercial success is difficult to predict and the marketing efforts of Rand's portfolio companies may not be successful.

### **Valuation of Portfolio Investments**

There is typically no public market of equity securities of the small privately held companies in which Rand invests. As a result, the valuation of the equity securities in Rand's portfolio is subject to the good faith estimate of Rand's Board of Directors. In the absence of a readily ascertainable market value, the estimated value of Rand's portfolio of securities may differ significantly from the values that would be placed on the portfolio if a ready market for the equity securities existed. Any changes in estimated net asset value are recorded in Rand's statement of operations as "Change in unrealized appreciation on investments".

### **Fluctuations of Quarterly Results**

Rand'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. As a result of these factors, results for any one quarter should not be relied upon as being indicative of performance in future quarters.

### **Changes In Interest Rates**

Rand has no borrowings; therefore, any change in interest rates will have no material impact on interest expense. A hypothetical 10% change in short-term interest rates on our income generated from cash and cash equivalent would not be material to the results of operations. Such discussion includes forward-looking statements of risks, which involve certain assumptions as to market interest rates. Actual market conditions may differ materially from such assumptions. Changes in interest rates may impact future interest income, however, through September 30, 2001, Rand has not held strong cash positions.

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

A portion of the Company's portfolio is in marketable securities traded in the over-the-counter market, and there is a portion of the Company'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 the markets to trade in an orderly fashion, the Company may not be able to realize the fair value of its marketable investments or other investments in a timely manner.

As of September 30, 2001, the Company did not have any off-balance sheet investments or hedging investments.

## **PART II OTHER INFORMATION**

Item 1. Legal Proceedings

None

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults upon Senior Securities Holders

None

Item 4. Submission of Matters to a Vote of Security Holders

Rand held its annual shareholder meeting on July 20, 2001. The following matters were submitted to a vote of shareholders: Election of Directors; Approval for BDC election; Approval of Stock Option Plans; and approval of independent auditors. Information concerning the results of these votes is presented in an attachment titled "Results of Balloting" to the Company's NSAR-A filed with the SEC on August 8, 2001, which information is incorporated herein by reference.

Item 5. Other Information

The Board of Directors has also authorized the repurchase of up to 5% of the Company's outstanding stock through purchases on the open market at any time, or from time to time, during the one-year period ending October 18, 2002, when, in the discretion of management, the price of the Company's stock does not appropriately reflect its net asset value

Item 6. Exhibits and Reports on Form 8-K

None

Signatures

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

Date: November 14, 2001

RAND CAPITAL CORPORATION

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

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