

Firsthand Technology Value Fund, Inc.
Form 10-K
March 21, 2012

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

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2011

or

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

For the transition period from _____ to _____
Commission file number: 814-00830

Firsthand Technology Value Fund, Inc.
(Exact name of registrant as specified in its charter)

MARYLAND
(State or Other Jurisdiction
of Incorporation or Organization)

77-6100553
(I.R.S. Employer
Identification No.)

150 Almaden Boulevard, Suite 1250
San Jose, California 95113
(Address and zip code of principal executive offices)
(408) 886-7096
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$.001 par value	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Edgar Filing: Firsthand Technology Value Fund, Inc. - Form 10-K

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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). (check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer <input checked="" type="checkbox"/> (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

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of June 30, 2011 was approximately \$52,170,656 (computed using the closing price of \$15.20 per share of Common Stock on June 30, 2011, as reported by the NASDAQ Global Market).

As of March 20, 2012, Firsthand Technology Value Fund had 3,496,480 shares of common stock, par value \$0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement prepared in connection with the Annual Meeting of Stockholders to be held in 2012 are incorporated by reference in Part III of this Form 10-K.

TABLE OF CONTENTS

PART I.

Item 1.	Business	4
Item 1A.	Risk Factors	18
Item 2.	Properties	25
Item 3.	Legal Proceedings	25
Item 4	Mine Safety Disclosures	25

PART II.

Item 5.	Market for Registrant's Common Equity, Related Matters, and Issuer Purchases of Equity Securities	25
Item 6.	Selected Financial Data	27
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	29
Item 8	Financial Statements and Supplemental Data	35
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	50
Item 9A.	Controls and Procedures	50
Item 9B.	Other Information	51

PART III.

Item 10.	Directors, Executive Officers, and Corporate Governance	51
Item 11.	Executive Compensation	51
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	51
Item 13.	Certain Relationships and Related Transactions and Director Independence	51
Item 14.	Principal Accountant Fees and Services	51

PART IV.

Item 15.	Exhibits and Financial Statements Schedules	52
----------	---	----

PART I

Item 1. Business

FORWARD LOOKING STATEMENTS

This report, and other statements that we may make, may contain forward-looking statements, which relate to future events or our future performance or financial condition. We use words such as “anticipates,” “believes,” “expects,” “plans,” “will,” “may,” “continues,” “believes,” “seeks,” “likely,” “intends,” and similar expressions to identify forward-looking statements. The forward-looking statements contained in this Annual Report on Form 10-K involve risks and uncertainties, including forward-looking statements as to:

- our future operating results,
- our business prospects and the prospects of our prospective portfolio companies,
 - the impact of investments that we expect to make,
 - our contractual arrangements and relationships with third parties,
- the dependence of our future success on the general economy and its impact on the industries in which we invest,
 - the ability of our prospective portfolio companies to achieve their objectives,
 - our expected financings and investments,
 - the adequacy of our cash resources and working capital, and
- the timing of cash flows, if any, from the operations of our prospective portfolio companies.

Our actual results could differ materially from those projected in the forward-looking statements for any reason, including the factors set forth in “Risk Factors” and elsewhere in this Annual Report on Form 10-K. In addition, several factors that could materially affect our actual results are the ability of the portfolio companies in which we invest to achieve their objectives; our ability to source favorable private investments; changes in the securities markets, especially the markets for technology companies including those that may be early stage or micro-cap companies; the dependence of our future success of the general economy and its impact on the industries in which we invest and other factors discussed in our periodic filings with the Securities and Exchange Commission (the “SEC”).

Unpredictable or unknown factors could also have material adverse effects on us. Since our actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements, we cannot give any assurance that any of the events anticipated by the forward-looking statements will occur, or, if any of them do, what impact they will have on our results of operations and financial condition. All forward-looking statements included in this Annual Report on Form 10-K are expressly qualified in their entirety by the foregoing cautionary statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to update, amend or clarify these forward-looking statements or the risk factors contained in this Annual Report on Form 10-K, whether as a result of new information, future events or otherwise, except as may be required under the federal securities laws. Although we undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise, you are advised to consult any additional disclosures that we may make directly to you or through reports that we in the future may file with the SEC.

GENERAL

Firsthand Technology Value Fund, Inc. (“we,” “us,” “our,” the “Company”) is an externally managed, closed-end, non-diversified management investment company organized as a Maryland corporation that has elected to be treated as a business development company (“BDC”) under the Investment Company Act of 1940 (the “1940 Act”). As such, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least 70 percent of our total assets in “qualifying assets,” including securities of private or micro-cap public U.S. companies, cash, cash equivalents, U.S. government securities and high-quality debt investments that mature in one year or less. In addition, for tax purposes we have elected to be treated as a regulated investment company, or RIC, under

Subchapter M of the Internal Revenue Code of 1986, as amended, which we refer to as the “Code.” Firsthand Capital Management, Inc. (the “Investment Adviser”, the “Adviser”, or “FCM”) serves as our investment adviser and manages the investment process on a daily basis.

We were incorporated under the Maryland General Corporation Law in April 2010 and acquired our initial portfolio of securities through the reorganization (the “Reorganization”) into us of Firsthand Technology Value Fund (“TVF”), an open-end mutual fund and a series of Firsthand Funds, which is a Delaware statutory trust. The reorganization was completed on April 15, 2011 and we commenced operations on April 18, 2011. Our initial portfolio consisted of eight investments with a fair market value of \$19,289,775 on the date of the Reorganization and \$69,428,581 in cash. Subsequent to the Reorganization we invested \$8,606,880 in additional investments, representing 12.4% of our investible funds.

Our investment objective is to seek long-term growth of capital, principally by seeking capital gains on our equity and equity-related investments. There can be no assurance that we will achieve our investment objective. Under normal circumstances, we invest at least 80 percent of our total assets for investment purposes in technology companies. We consider technology companies to be those companies that derive at least 50 percent of their revenues from products and/or services within the information technology sector and in the “cleantech” sector. Information technology companies include, but are not limited to, those focused on computer hardware, software, telecommunications, networking, Internet, and consumer electronics. While there is no standard definition of cleantech, it is generally regarded as including goods and services designed to harness renewable energy and materials, eliminate emissions and waste, and reduce the use of natural resources. In addition, under normal circumstances we invest at least 70 percent of our assets in privately held companies and public companies with market capitalizations less than \$250 million. Our portfolio is primarily composed of equity and equity derivative securities of technology and cleantech companies (as defined above). These investments generally range between \$1 million and \$10 million each, although the investment size will vary proportionately with the size of our capital base. We acquire our investments through direct investments in private companies, negotiations with selling shareholders, and in organized secondary marketplaces for private securities.

Our current focus is on investing in late-stage private companies, particularly those with potential for near-term realizations by way of an initial public offering (“IPO”) or acquisition. As of December 31, 2011, we owned 500,000 shares of common stock of Yelp, Inc. and 50,000 shares of Facebook Inc. On November 17, 2011, Yelp, Inc. filed a registration statement with the SEC in connection with its proposed initial public offering and on February 2, 2012, Facebook Inc. filed a registration statement with the SEC in connection with its proposed initial public offering.

While our primary focus is to invest in illiquid private technology and cleantech companies, we may also invest in micro-cap publicly traded companies. In addition, we may invest up to 30% of the portfolio in opportunistic investments that do not constitute the private companies and micro-cap public companies described above. These other investments may include investments in securities of public companies that are actively traded. These other investments may also include investments in high-yield bonds, distressed debt, or securities of public companies that are actively traded; and securities of companies located outside of the United States. Our investment activities are managed by FCM.

Neither our investments nor an investment in us are intended to constitute a balanced investment program. We expect to be risk-seeking rather than risk-averse in our investment approach. There is no assurance that our investment objective will be achieved.

We invest a substantial portion of our assets in securities that we consider to be private venture capital equity investments. These private venture capital equity investments usually do not pay interest or dividends and usually are subject to legal or contractual restrictions on resale that may adversely affect the liquidity and marketability of such securities. We expect to make speculative venture capital investments with limited marketability and a greater risk of investment loss than less-speculative investments. Subject to the diversification requirements applicable to a regulated investment company (“RIC”), we may commit all of our assets to only a few investments.

Subject to continuing to meet the compliance tests applicable to BDCs, there are no limitations on the types of securities or other assets in which we may invest. Investments may include the following:

- Venture capital investments, whether in corporate, partnership, or other form, including development-stage or start-up entities;
- Equity, equity-related securities (including warrants), and debt with equity features from either private or public issuers;

- Debt obligations of all types having varying terms with respect to security or credit support, subordination, purchase price, interest payments, and maturity;
 - Foreign securities;
- Intellectual property or patents or research and development in technology or product development that may lead to patents or other marketable technology; and
 - Miscellaneous investments.

During the period from our inception (April 18, 2011) through December 31, 2011, we made follow-on investments in Silicon Genesis Corporation and SoloPower, Inc., investing a total of \$1 million in these two solar-related companies.

We also invested in three new private companies during the period. In October, we made our first investment in Facebook Inc. The social networking company has more than 800 million users worldwide and the Adviser believes that its committed user base and significant competitive advantages have created an enormous opportunity for the company to drive advertising revenues.

In November, we invested in Skyline Solar, Inc., a California-based manufacturer of concentrated solar photovoltaic (PV) systems. The Adviser believes that Skyline's unique approach gives the company an opportunity to become a low-cost leader in the utility-scale PV market.

In December, we made an investment in Yelp, Inc., which operates a social networking website that allows users to search for and post reviews of local businesses. The Investment Adviser believes that the company's strong brand in the local search market has made it an attractive and fast-growing advertising platform for local restaurants and other businesses.

For defensive purposes, we also made a number of purchases of put options on the PowerShares QQQ Index Tracking Trust. These investments are generally negatively correlated with the performance of the NASDAQ 100 Index.

The table below provides a summary of our investments as of December 31, 2011.

INVESTMENT	BUSINESS DESCRIPTION	FAIR VALUE ¹
Facebook, Inc.	Social Networking	\$1,550,000
INNOViON	Ion Implant Foundry	\$173,396
Intevac, Inc. ²	Manufacturing Equipment	\$4,034,154
IP Unity	Mobile Communications Software	\$298
Silicon Genesis Corp.	Intellectual Property	\$2,837,121
Skyline Solar, Inc.	Concentrated Photovoltaic Systems	\$868,016
SoloPower, Inc.	Solar Photovoltaic Modules	\$3,094,519
UCT Coatings, Inc.	Advanced Materials	\$0
Yelp, Inc.	Social Networking	\$2,925,000

¹ Fair value for our private company holdings was determined in good faith by our board of directors on December 31, 2011. For public companies, the figure represents the market value of our securities on December 31, 2011.

INVESTMENTS AND STRATEGIES

The following is a summary description of the types of assets in which we may invest, the investment strategies we may use, and the attendant risks associated with our investments and strategies.

VENTURE CAPITAL INVESTMENTS

We define venture capital as the money and resources made available to privately held start-up firms and privately held and publicly traded small businesses with exceptional growth potential. These businesses can range in stage from pre-revenue to generating positive cash flow. Most of our long-term venture capital investments are in thinly capitalized, unproven, small

companies focused on commercializing risky technologies. These businesses also tend to lack management depth, have limited or no history of operations, and have not attained profitability. Because of the speculative nature of these investments, these securities have a significantly greater risk of loss than traditional investment securities. Some of our venture capital investments will never realize their potential, and some will be unprofitable or result in the complete loss of our investment.

We acquire our investments through direct investments in private companies, negotiations with selling shareholders, and in organized secondary marketplaces for private securities. Our current focus is on investing in late-stage private companies, particularly those with potential for near-term realizations by way of IPO or acquisition.

In connection with our venture capital investments, we may participate in providing a variety of services to our portfolio companies, including the following:

- Recruiting management,
- Formulating operating strategies,
- Formulating intellectual property strategies,
 - Assisting in financial planning,
- Providing management in the initial start-up stages, and
 - Establishing corporate goals.

We may assist in raising additional capital for these companies from other potential investors and may subordinate our own investment to that of other investors. We typically find it necessary or appropriate to provide additional capital of our own. We may introduce these companies to potential joint venture partners, suppliers, and customers. In addition, we may assist in establishing relationships with investment bankers and other professionals. We may also assist with mergers and acquisitions (“M&As”). We do not currently derive income from these companies for the performance of any of the above services.

We may control, be represented on, or have observer rights on the Board of Directors of a portfolio company through one or more of our officers or directors, who may also serve as officers of the portfolio company. We indemnify our officers and directors for serving on the Boards of Directors or as officers of portfolio companies, which exposes us to additional risks. Particularly during the early stages of an investment, we may, in rare instances, in effect be conducting the operations of the portfolio company. Our goal is to assist each company in establishing its own independent capitalization, management, and Board of Directors. As a venture capital-backed company emerges from the developmental stage with greater management depth and experience, we expect that our role in the portfolio company’s operations will diminish.

EQUITY, EQUITY-RELATED SECURITIES AND DEBT WITH EQUITY FEATURES

We may invest in equity, equity-related securities, and debt with equity features. These securities include common stock, preferred stock, debt instruments convertible into common or preferred stock, limited partnership interests, other beneficial ownership interests and warrants, options, or other rights to acquire any of the foregoing.

We may make investments in companies with operating histories that are unprofitable or marginally profitable, that have negative net worth, or that are involved in bankruptcy or reorganization proceedings. These investments would involve businesses that management believes have potential through the infusion of additional capital and management assistance. In addition, we may make investments in connection with the acquisition or divestiture of companies or divisions of companies. There is a significantly greater risk of loss with these types of securities than is the case with traditional investment securities.

Warrants, options, and convertible or exchangeable securities generally give the investor the right to acquire specified equity securities of an issuer at a specified price during a specified period or on a specified date. Warrants and options fluctuate in value in relation to the value of the underlying security and the remaining life of the warrant or option, while convertible or exchangeable securities fluctuate in value both in relation to the intrinsic value of the security without the conversion or exchange feature and in relation to the value of the conversion or exchange feature, which is like a warrant or an option. When we invest in these securities, we incur the risk that the option feature will expire worthless, thereby either eliminating or diminishing the value of our investment.

Most of our current portfolio company investments are in the equity securities of private companies. Investments in equity securities of private companies often involve securities that are restricted as to sale and cannot be sold in the open market without

registration under the Securities Act of 1933 or pursuant to a specific exemption from these registrations. Opportunities for sale are more limited than in the case of marketable securities, although these investments may be purchased at more advantageous prices and may offer attractive investment opportunities. Even if one of our portfolio companies completes an IPO, we are typically subject to a lock-up agreement for 180 days, and the stock price may decline substantially before we are free to sell.

We may also invest in publicly traded securities of whatever nature, including relatively small, emerging growth companies that management believes have long-term growth potential. These investments may be through open-market transactions or through private placements in publicly traded companies (“PIPEs”). Securities purchased in PIPE transactions are typically subject to a lock-up agreement for 180 days, or are issued as unregistered securities that are not freely available for six months.

Even if we have registration rights to make our investments in privately held and publicly traded companies more marketable, a considerable amount of time may elapse between a decision to sell or register the securities for sale and the time when we are able to sell the securities. The prices obtainable upon sale may be adversely affected by market conditions or negative conditions affecting the issuer during the intervening time. We may elect to hold formerly restricted securities after they have become freely marketable, either because they remain relatively illiquid or because we believe that they may appreciate in value, during which holding period they may decline in value and be especially volatile as unseasoned securities. If we need funds for investment or working capital purposes, we might need to sell marketable securities at disadvantageous times or prices.

DEBT OBLIGATIONS

We may hold debt securities, including in privately held and thinly traded public companies, for income and as a reserve pending more speculative investments. Debt obligations may include U.S. government and agency securities, commercial paper, bankers’ acceptances, receivables or other asset-based financing, notes, bonds, debentures, or other debt obligations of any nature and repurchase agreements related to these securities. These obligations may have varying terms with respect to security or credit support; subordination; purchase price; interest payments; and maturity from private, public, or governmental issuers of any type located anywhere in the world. We may invest in debt obligations of companies with operating histories that are unprofitable or marginally profitable, that have negative net worth or are involved in bankruptcy or reorganization proceedings, or that are start-up or development-stage entities. In addition, we may participate in the acquisition or divestiture of companies or divisions of companies through issuance or receipt of debt obligations. As of December 31, 2011, the debt obligations held in our portfolio consisted entirely of convertible bridge notes. The convertible bridge notes generally do not generate cash payments to us, nor are they held for that purpose. Our convertible bridge notes and the interest accrued thereon are held for the purpose of potential conversion into equity at a future date.

Our investments in debt obligations may be of varying quality, including non-rated, unsecured, highly speculative debt investments with limited marketability. Investments in lower-rated and non-rated securities, commonly referred to as “junk bonds,” including our venture debt investments, are subject to special risks, including a greater risk of loss of principal and non-payment of interest. Generally, lower-rated securities offer a higher return potential than higher-rated securities, but involve greater volatility of price and greater risk of loss of income and principal, including the possibility of default or bankruptcy of the issuers of these securities. Lower-rated securities and comparable non-rated securities will likely have large uncertainties or major risk exposure to adverse conditions and are predominantly speculative with respect to the issuer’s capacity to pay interest and repay principal in accordance with the terms of the obligation. The occurrence of adverse conditions and uncertainties to issuers of lower-rated securities would likely reduce the value of lower-rated securities held by us, with a commensurate effect on the value of our shares.

The markets in which lower-rated securities or comparable non-rated securities are traded generally are more limited than those in which higher-rated securities are traded. The existence of limited markets for these securities may restrict our ability to obtain accurate market quotations for the purposes of valuing lower-rated or non-rated securities and calculating net asset value or to sell securities at their fair value. Any economic downturn could adversely affect the ability of issuers' lower-rated securities to repay principal and pay interest thereon. The market values of lower-rated and non-rated securities also tend to be more sensitive to individual corporate developments and changes in economic conditions than higher-rated securities. In addition, lower-rated securities and comparable non-rated securities generally present a higher degree of credit risk. Issuers of lower-rated securities and comparable non-rated securities are often highly leveraged and may not have more traditional methods of financing available to them, so that their ability to service their debt obligations during an economic downturn or during sustained periods of rising interest rates may be impaired. The risk of loss owing to default by these issuers is significantly greater because lower-rated securities and comparable non-rated securities generally are unsecured and frequently are subordinated to the prior payment of senior indebtedness. We may incur additional expenses to the extent that we are required to seek recovery upon a default in the payment of principal or interest on our portfolio holdings.

The market value of investments in debt securities that carry no equity participation usually reflects yields generally available on securities of similar quality and type at the time purchased. When interest rates decline, the market value of a debt portfolio already invested at higher yields can be expected to rise if the securities are protected against early call. Similarly, when interest rates increase, the market value of a debt portfolio already invested at lower yields can be expected to decline. Deterioration in credit quality also generally causes a decline in market value of the security, while an improvement in credit quality generally leads to increased value.

FOREIGN SECURITIES

We may make investments in securities of issuers whose principal operations are conducted outside the United States, and whose earnings and securities are stated in foreign currency. In order to maintain our status as a BDC, our investments in non-qualifying assets, including the securities of companies organized outside the U.S., would be limited to 30 percent of our assets, because we must invest at least 70 percent of our assets in “qualifying assets,” and securities of foreign companies are not “qualifying assets.”

Compared to otherwise comparable investments in securities of U.S. issuers, currency exchange risk of securities of foreign issuers is a significant variable. The value of these investments to us will vary with the relation of the currency in which they are denominated to the U.S. dollar, as well as with intrinsic elements of value such as credit risk, interest rates, and performance of the issuer. Investments in foreign securities also involve risks relating to economic and political developments, including nationalization, expropriation of assets, currency exchange freezes, and local recession. Securities of many foreign issuers are less liquid and more volatile than those of comparable U.S. issuers. Interest and dividend income and capital gains on our foreign securities may be subject to withholding and other taxes that may not be recoverable by us. We may seek to hedge all or part of the currency risk of our investments in foreign securities through the use of futures, options, and forward currency purchases or sales.

INTELLECTUAL PROPERTY

We believe there is a role for organizations that can assist in technology transfer. Scientists and institutions that develop and patent intellectual property perceive the need for and rewards of entrepreneurial commercialization of their inventions. Our form of investment may be:

- Funding research and development in the development of a technology,
 - Obtaining licensing rights to intellectual property or patents,
 - Acquiring intellectual property or patents, or
- Forming and funding companies or joint ventures to commercialize further intellectual property.

Income from our investments in intellectual property or its development may take the form of participation in licensing or royalty income, fee income, or some other form of remuneration. In order to satisfy RIC requirements, these investments will normally be held in an entity taxable as a corporation. Investment in developmental intellectual property rights involves a high degree of risk that can result in the loss of our entire investment as well as additional risks, including uncertainties as to the valuation of an investment and potential difficulty in liquidating an investment. Further, investments in intellectual property generally require investor patience, as investment return may be realized only after or over a long period. At some point during the commercialization of a technology, our investment may be transformed into ownership of securities of a development-stage or start-up company, as discussed under “Venture Capital Investments” above.

REPURCHASE OF SHARES

Our shareholders do not have the right to compel us to redeem our shares. We may, however, purchase outstanding shares of our common stock from time to time, subject to approval of our Board of Directors and in compliance with applicable corporate and securities laws. The Board of Directors may authorize purchases from time to time when they

are deemed to be in the best interests of our shareholders, but could do so only after notification to shareholders. The Board of Directors may or may not decide to undertake any purchases of our common stock.

Our repurchases of our common shares would decrease our total assets and would therefore likely have the effect of increasing our expense ratio. Subject to our investment restrictions, we may borrow money to finance the repurchase of our common stock in the open market pursuant to any tender offer. Interest on any borrowings to finance share repurchase transactions

would reduce our net assets. If, because of market fluctuations or other reasons, the value of our assets falls below the required 1940 Act coverage requirements, we may have to reduce our borrowed debt to the extent necessary to comply with the requirement. To achieve a reduction, it is possible that we may be required to sell portfolio securities at inopportune times when it may be disadvantageous to do so.

PORTFOLIO COMPANY TURNOVER

Changes with respect to portfolio companies will be made as our management considers necessary in seeking to achieve our investment objective. The rate of portfolio turnover will not be treated as a limiting or relevant factor when circumstances exist that are considered by management to make portfolio changes advisable.

Although we expect that many of our investments will be relatively long term in nature, we may make changes in particular portfolio holdings whenever it is considered that an investment no longer has substantial growth potential or has reached its anticipated level of performance, or (especially when cash is not otherwise available) that another investment appears to have a relatively greater opportunity for capital appreciation. We may also make general portfolio changes to increase our cash to position us in a defensive posture. We may make portfolio changes without regard to the length of time we have held an investment, or whether a sale results in profit or loss, or whether a purchase results in the reacquisition of an investment that we may have only recently sold. Our investments in privately held companies are illiquid, which limits portfolio turnover. The portfolio turnover rate may vary greatly during a year as well as from year to year and may also be affected by cash requirements.

COMPETITION

We compete for investments with a number of business development companies and other investment funds (including private equity funds and venture capital funds), reverse merger and special purpose acquisition company (“SPACs”) sponsors, investment bankers that underwrite initial public offerings, hedge funds that invest in private investments in public equities (PIPEs), traditional financial services companies such as commercial banks, and other sources of financing. Many of these entities have greater financial and managerial resources than we do. Furthermore, many of our competitors are not subject to the regulatory restrictions that the 1940 Act will impose on us as a business development company. We believe we compete with these entities primarily on the basis of our willingness to make smaller, non-controlling investments, the experience and contacts of our investment professionals within our targeted industries, our responsive and efficient investment analysis and decision-making processes, and the investment terms that we offer. We do not seek to compete primarily on the deal terms we offer to potential portfolio companies. We use the industry information available to FCM to assess investment risks and determine appropriate pricing for our investments in portfolio companies. In addition, we believe that the relationships of Kevin Landis (FCM’s President and Chief Investment Officer), and the other senior investment professionals FCM retains, enable us to learn about, and compete effectively for, financing opportunities with attractive companies in the industries in which we seek to invest. For additional information concerning the competitive risks we face, see “Risk Factors—Risks relating to our business and structure—We operate in a highly competitive market for investment opportunities.”

REGULATION

The Small Business Investment Incentive Act of 1980 added the provisions of the 1940 Act applicable only to BDCs. BDCs are a special type of investment company. After a company files its election to be treated as a BDC, it may not withdraw its election without first obtaining the approval of holders of a majority of its outstanding voting securities. The following is a brief description of the 1940 Act provisions applicable to BDCs, qualified in its entirety by reference to the full text of the 1940 Act and the rules issued thereunder by the Securities and Exchange Commission (“SEC”).

Generally, to be eligible to elect BDC status, a company must primarily engage in the business of furnishing capital and making significant managerial assistance available to companies that do not have ready access to capital through conventional financial channels. Such companies that satisfy certain additional criteria described below are termed “eligible portfolio companies.” In general, in order to qualify as a BDC, a company must: (i) be a domestic company; (ii) have registered a class of its securities pursuant to Section 12 of the Securities Exchange Act of 1934 (the “Exchange Act”); (iii) operate for the purpose of investing

in the securities of certain types of portfolio companies, including early-stage or emerging companies and businesses suffering or just recovering from financial distress (see following paragraph); (iv) make available significant managerial assistance to such portfolio companies; and (v) file a proper notice of election with the SEC.

An eligible portfolio company generally is a domestic company that is not an investment company or a company excluded from investment company status pursuant to exclusions for certain types of financial companies (such as brokerage firms, banks, insurance companies, and investment banking firms) and that: (i) has a fully diluted market capitalization of less than \$250 million and has a class of equity securities listed on a national securities exchange, (ii) does not have a class of securities listed on a national securities exchange, or (iii) is controlled by the BDC by itself or together with others (control under the 1940 Act is presumed to exist where a person owns at least 25 percent of the outstanding voting securities of the portfolio company) and the BDC has a representative on the Board of Directors of such company.

We may be examined periodically by the SEC for compliance with the 1940 Act.

As with other companies regulated by the 1940 Act, a BDC must adhere to certain substantive regulatory requirements. A majority of our directors must be persons who are not interested persons, as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect the BDC. Furthermore, as a BDC, we are prohibited from protecting any director or officer against any liability to us or our shareholders arising from willful malfeasance, bad faith, gross negligence, or reckless disregard of the duties involved in the conduct of such person's office.

The 1940 Act provides that we may not make an investment in non-qualifying assets unless at the time at least 70 percent of the value of our total assets (measured as of the date of our most recently filed financial statements) consists of qualifying assets. Qualifying assets include: (i) securities of eligible portfolio companies; (ii) securities of certain companies that were eligible portfolio companies at the time we initially acquired their securities and in which we retain a substantial interest; (iii) securities of certain controlled companies; (iv) securities of certain bankrupt, insolvent, or distressed companies; (v) securities received in exchange for or distributed in or with respect to any of the foregoing; and (vi) cash items, U.S. government securities, and high quality short-term debt. The SEC has adopted a rule permitting a BDC to invest its cash in certain money market funds. The 1940 Act also places restrictions on the nature of the transactions in which, and the persons from whom, securities can be purchased in some instances in order for the securities to be considered qualifying assets.

We are permitted by the 1940 Act, under specified conditions, to issue multiple classes of debt and a single class of preferred stock if our asset coverage, as defined in the 1940 Act, is at least 200 percent after the issuance of the debt or the preferred stock (i.e., such senior securities may not be in excess of our net assets). Under specific conditions, we are also permitted by the 1940 Act to issue warrants.

Except under certain conditions, we may sell our securities at a price that is below the prevailing net asset value per share only during the 12-month period after (i) a majority of our directors and our disinterested directors have determined that such sale would be in the best interest of us and our stockholders, and (ii) the holders of a majority of our outstanding voting securities and the holders of a majority of our voting securities held by persons who are not affiliated persons of ours approve our ability to make such issuances. A majority of the disinterested directors must determine in good faith that the price of the securities being sold is not less than a price that closely approximates the market value of the securities, less any distribution discount or commission.

Certain transactions involving certain closely related persons of the Company, including its directors, officers, and employees, may require the prior approval of the SEC. However, the 1940 Act ordinarily does not restrict transactions between us and our portfolio companies.

SUBCHAPTER M STATUS

We elected to be treated as a RIC, taxable under Subchapter M of the Internal Revenue Code of 1986 (the “Code”), for federal income tax purposes. In general, a RIC is not taxable on its income or gains to the extent it distributes such income or gains to its shareholders. In order to qualify as a RIC, we must, in general, (1) annually derive at least 90 percent of our gross income

from dividends, interest, and gains from the sale of securities and similar sources (the “Income Source Rule”); (2) quarterly meet certain investment asset diversification requirements; and (3) annually distribute at least 90 percent of our investment company taxable income as a dividend (the “Income Distribution Rule”). Any taxable investment company income not distributed will be subject to corporate level tax. Any taxable investment company income distributed generally will be taxable to shareholders as dividend income.

Although we may retain income and gains subject to the limitations described above (including paying corporate level tax on such amounts), we could be subject to an additional four percent excise tax if we fail to distribute 98 percent of our aggregate annual taxable income.

As noted above, in order to qualify as a RIC, we must meet certain investment asset diversification requirements each quarter. Because of the specialized nature of our investment portfolio, in some years we have been able to satisfy the diversification requirements under Subchapter M of the Code primarily as a result of receiving certifications from the SEC under the Code with respect to each taxable year beginning after 1998 that we were “principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available” for such year.

Although we generally intend to qualify as a RIC for each taxable year, under certain circumstances we may choose to take action with respect to one or more taxable years to ensure that we would be taxed under Subchapter C of the Co