

RAND CAPITAL CORP  
Form 10-Q  
May 15, 2007

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**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 March 31, 2007**

**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: 001-08205**

**Rand Capital Corporation**

*(Exact Name of Registrant as specified in its Charter)*

**New York**

(State or Other Jurisdiction of Incorporation  
or organization)

**16-0961359**

(IRS Employer  
Identification No.)

**2200 Rand Building, Buffalo, NY**

(Address of Principal executive offices)

**14203**

(Zip Code)

**(716) 853-0802**

*(Registrant's Telephone No. Including Area Code)*

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 or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 under the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No   
As of May 7, 2007 there were 5,718,934 shares of the registrant's common stock outstanding.

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**PART I.**  
**FINANCIAL INFORMATION**

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

**Rand Capital Corporation and Subsidiaries**  
**Consolidated Statements of Financial Position**  
**As of March 31, 2007 and December 31, 2006**

|  | March 31,<br>2007<br>(Unaudited) | December 31,<br>2006 |
|--|----------------------------------|----------------------|
| <b>ASSETS</b>  |                                  |                      |
| Investments at fair value (identified cost: 3/31/07 - \$13,126,870; 12/31/06 - \$14,033,789) | \$ 22,852,516                    | \$ 23,649,814        |
| Cash and cash equivalents  | 4,215,573                        | 4,299,852            |
| Interest receivable (net of allowance: 3/31/07 - \$122,000; 12/31/06 - \$122,000)            | 503,861                          | 507,242              |
| Other assets   | 1,314,801                        | 1,007,036            |
| <b>Total assets</b>  | <b>\$ 28,886,751</b>             | <b>\$ 29,463,944</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY (NET ASSETS)</b>                                      |                                  |                      |
| <b>Liabilities:</b>  |                                  |                      |
| Debentures guaranteed by the SBA   | \$ 8,100,000                     | \$ 8,100,000         |
| Deferred income taxes  | 3,412,000                        | 3,808,000            |
| Income tax payable   | 8,591                            | 410,575              |
| Accounts payable and accrued expenses  | 95,657                           | 317,359              |
| Deferred revenue   | 40,377                           | 45,605               |
| Total liabilities  | 11,656,625                       | 12,681,539           |
| <b>Stockholders equity (net assets):</b>   |                                  |                      |
| Common stock, \$.10 par shares authorized 10,000,000; shares issued 5,763,034                | 576,304                          | 576,304              |
| Capital in excess of par value   | 6,973,454                        | 6,973,454            |
| Accumulated net investment (loss)  | (6,162,940)                      | (6,253,128)          |
| Undistributed net realized gain on investments   | 9,724,130                        | 9,763,366            |
| Net unrealized appreciation on investments   | 6,166,384                        | 5,769,615            |
| Treasury stock, at cost, 44,100 shares   | (47,206)                         | (47,206)             |
| Net assets (per share: 3/31/07-\$3.01 , 12/31/2006-\$2.93)                                   | 17,230,126                       | 16,782,405           |
| <b>Total liabilities and stockholders equity (net assets)</b>                                | <b>\$ 28,886,751</b>             | <b>\$ 29,463,944</b> |

See accompanying notes



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**Rand Capital Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Operations**  
**For the Three Months Ended March 31, 2007 and 2006**  
**(Unaudited)**

|  | <b>Three<br/>months<br/>ended<br/>March 31,<br/>2007</b> | <b>Three months<br/>ended<br/>March 31,<br/>2006</b> |
|--|--|--|
| <b>Investment income:</b>                              |  |  |
| Interest from portfolio companies                      | \$ 199,717   | \$ 172,020   |
| Interest from other investments                        | 46,047   | 5,143  |
| Dividend and other investment income                   | 229,420  | 13,135   |
| Other income   | 5,228  | 10,947   |
|  | 480,412  | 201,245  |
| <b>Operating expenses:</b>                             |  |  |
| Salaries   | 106,970  | 96,284   |
| Employee benefits                                      | 42,313   | 31,926   |
| Directors fees   | 12,250   | 13,500   |
| Professional fees                                      | 31,678   | 26,536   |
| Stockholders and office operating                      | 32,413   | 26,228   |
| Insurance  | 10,920   | 10,920   |
| Corporate development                                  | 14,790   | 12,905   |
| Other operating  | 2,479  | 2,622  |
|  | 253,813  | 220,921  |
| Interest on SBA obligations                            | 125,766  | 106,924  |
| Total expenses   | 379,579  | 327,845  |
| <b>Investment gain (loss) before income taxes</b>      | 100,833  | (126,600)  |
| Current income tax expense                             | 98,297   | 5,000  |
| Deferred income tax (benefit) expense                  | (98,668)   | 11,089   |
| <b>Net investment gain (loss)</b>                      | 101,204  | (142,689)  |
| <b>Realized and unrealized gain on investments:</b>    |  |  |
| Net (loss) gain on sales and dispositions              | (39,236)   | 187,953  |
| Unrealized appreciation (depreciation) on investments: |  |  |
| Beginning of period                                    | 9,616,025  | (342,028)  |
| End of period  | 9,725,646  | (94,751)   |

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|   |            |            |
|---|------------|------------|
| Change in unrealized appreciation (depreciation) before income taxes          | 109,621    | 247,277    |
| Deferred income tax expense   | 40,121     | 98,911     |
| <b>Net change in unrealized appreciation (depreciation) on investments</b>    | 69,500     | 148,366    |
| <b>Net realized and unrealized gain on investments</b>                        | 30,264     | 336,319    |
| <b>Net increase in net assets from operations</b>                             | \$ 131,468 | \$ 193,630 |
| <b>Weighted average shares outstanding</b>                                    | 5,718,934  | 5,718,934  |
| <b>Basic and diluted net increase in net assets from operations per share</b> | \$ 0.02    | \$ 0.03    |
| See accompanying notes  |            |            |

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**Rand Capital Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
**For the Three Months Ended March 31, 2007 and 2006**  
**(Unaudited)**

|   | <b>March 31, 2007</b> | <b>March 31, 2006</b> |
|---|-----------------------|-----------------------|
| <b>Cash flows from operating activities:</b>  |                       |                       |
| Net increase in net assets from operations  | \$ 131,468            | \$ 193,630            |
| Adjustments to reconcile net increase in net assets to net cash used in operating activities: |                       |                       |
| Depreciation and amortization   | 8,496                 | 7,708                 |
| Original issue discount amortization  | (62,333)              |                       |
| Increase in unrealized appreciation of investments  | (109,621)             | (247,277)             |
| Deferred tax expense (benefit)  | (58,547)              | 110,000               |
| Net realized loss (gain) on portfolio investments   | 39,236                | (187,953)             |
| Non-cash conversion of debenture interest   | (40,000)              | (2,877)               |
| Changes in operating assets and liabilities:  |                       |                       |
| Decrease (increase) in interest receivable  | 3,381                 | (31,344)              |
| (Increase) decrease in other assets   | (314,910)             | 30,986                |
| Decrease in accounts payable and accrued liabilities  | (644,886)             | (95,922)              |
| Decrease in deferred revenue  | (5,228)               | (3,948)               |
| Total adjustments   | (1,184,412)           | (420,627)             |
| <b>Net cash used in operating activities</b>  | <b>(1,052,944)</b>    | <b>(226,997)</b>      |
| <b>Cash flows from investing activities:</b>  |                       |                       |
| Investments originated  |                       | (800,000)             |
| Proceeds from sale of portfolio investments   |                       | 581,396               |
| Proceeds from loan repayments   | 970,015               | 26,544                |
| Capital expenditures  | (1,350)               |                       |
| <b>Net cash provided (used) by investing activities</b>                                       | <b>968,665</b>        | <b>(192,060)</b>      |
| <b>Net decrease in cash and cash equivalents</b>  | <b>(84,279)</b>       | <b>(419,057)</b>      |
| <b>Cash and cash equivalents:</b>   |                       |                       |
| Beginning of period   | 4,299,852             | 1,209,839             |
| End of period   | \$ 4,215,573          | \$ 790,782            |

See accompanying notes



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**Rand Capital Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Changes in Net Assets**  
**For the Three Months Ended March 31, 2007 and 2006**  
**(Unaudited)**

|   | <b>Three<br/>months<br/>ended<br/>March 31,<br/>2007</b> | <b>Three months<br/>ended<br/>March 31,<br/>2006</b> |
|---|--|--|
| <b>Net assets at beginning of period</b>                        | \$ 16,782,405  | \$ 8,615,934   |
| Cumulative effect adjustment for uncertain tax positions FIN 48 | 316,253  |  |
| Net investment gain (loss)                                      | 101,204  | (142,689)  |
| Net realized gain (loss) on investments                         | (39,236)   | 187,953  |
| Net change in unrealized appreciation on investments            | 69,500   | 148,366  |
| Net increase in net assets                                      | 447,721  | 193,630  |
| <b>Net assets at end of period</b>                              | <b>\$ 17,230,126</b>                                     | <b>\$ 8,809,564</b>                                  |

See accompanying notes

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**Rand Capital Corporation and Subsidiaries**  
**Condensed Consolidated Schedule of Portfolio Investments**  
**March 31, 2007**  
**(Unaudited)**

| <b>Company and Business</b>   | <b>Type of Investment</b>   | <b>(b)<br/>Date</b> | <b>(c)<br/>Acquired Equity</b> | <b>Cost</b> | <b>(d)<br/>Value</b> | <b>Per<br/>Share<br/>of<br/>Rand</b> |
|---|---|---------------------|--------------------------------|-------------|----------------------|--------------------------------------|
| <b>Adampluseve, Inc. (g)</b><br>New York, NY. Luxury sports wear company for men and women.<br>www.adampluseve.com  | Warrants to purchase 1,715 Series A Convertible Preferred shares.   | 7/14/06             | 3%                             | \$ 68,000   | \$ 133,341           | .02                                  |
| <b>APF Group, Inc. (g)(h)</b><br>Mount Vernon, NY. Manufacturer of museum quality picture frames and framed mirrors for museums, art galleries, retail frame shops, upscale designers and prominent collectors.<br>www.apfgroup.com | \$584,328 Consolidated Senior Subordinated note at 12.74% due June 30, 2011. Warrants to purchase 10.2941 shares of common stock. | 7/8/04              | 6%                             | 570,960     | 570,960              | .10                                  |
| <b>Carolina Skiff LLC (e)(g)</b><br>Waycross, GA. Manufacturer of fresh water, ocean fishing and pleasure boats.<br>www.carolinaskiff.com   | \$985,000 Class A preferred membership interest at 11%. Redeemable January 31, 2010. 5% common membership interest.               | 1/30/04             | 5%                             | 1,000,000   | 1,227,000            | .21                                  |
| <b>Contract Staffing</b><br>Buffalo, NY. PEO providing human resource administration for small businesses.<br>www.contract-staffing.com   | Preferred Stock Repurchase Agreement through March 31, 2010 at 5%.  | 11/8/99             | 10%                            | 141,400     | 141,400              | .02                                  |
| <b>EmergingMed.com, Inc. (g)</b><br>New York, NY. Cancer clinical trial matching and referral service.<br>www.emergingmed.com   | \$500,000 Senior subordinated note at 10% due December 19, 2010.  | 12/19/05            | 5%                             | 500,000     | 500,000              | .09                                  |
| <b>Gemcor II, LLC (e)(g)(h)</b><br>West Seneca, NY. Designs and sells automatic riveting machines used in the assembly of aircraft components.  | \$250,000 Subordinated note at 8% due June 28, 2010 with warrant to purchase 6.25 membership units. 25                            | 6/28/04             | 31%                            | 708,989     | 708,989              | .12                                  |

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|  |  |         |     |           |           |      |
|--|--|---------|-----|-----------|-----------|------|
| www.gemcor.com   | membership units.  |         |     |           |           |      |
| <b>G-TEC Natural Gas Systems</b><br>Buffalo, NY. Manufactures and distributes systems that allow natural gas to be used as an alternative fuel to gases.<br>www.gas-tec.com                            | 33.057% Class A membership interest. 8% cumulative dividend.   | 8/31/99 | 33% | 400,000   | 198,000   | .03  |
| <b>Innov-X Systems, Inc. (g)</b><br>Woburn, MA. Manufactures portable x-ray fluorescence (XRF) analyzers used in metals/alloy analysis.<br>www.innovxsys.com   | 2,642 Series A Convertible Preferred stock. Warrants for 21,596 common shares.   | 9/27/04 | 9%  | 1,000,000 | 8,761,700 | 1.53 |
| <b>Kionix, Inc.</b><br>Ithaca, NY. Develops innovative MEMS based technology applications.<br>www.kionix.com   | 30,241 shares Series B preferred stock. 696,296 shares Series C preferred stock. (g) 2,862,091 shares Series A preferred stock. 714,285 shares Series B preferred stock. | 5/17/02 | 2%  | 1,506,044 | 1,221,568 | .21  |
| <b>New Monarch Machine Tool, Inc. (e)(g)(h)</b><br>Cortland, NY. Manufactures and services vertical/horizontal machining centers.<br>www.monarchmt.com   | \$527,877 note at 12% due January 13, 2009. \$300,000 note at 12% due January 13, 2009. Warrants for 22.84 shares of common stock.                                       | 9/24/03 | 11% | 651,333   | 651,333   | .11  |
| <b>Niagara Dispensing Technologies, Inc. (g)</b><br>Tonawanda, NY. Beverage dispensing technology development and products manufacturer, specializing in beer dispensing systems.<br>www.exactpour.com | \$500,000 Senior Subordinated note at 8% due March 7, 2011. Adjustable warrant for 4% of common stock.   | 3/8/06  | 4%  | 540,000   | 540,000   | .09  |

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**Rand Capital Corporation and Subsidiaries**  
**Condensed Consolidated Schedule of Portfolio Investments**  
**March 31, 2007 (Continued)**  
**(Unaudited)**

| <b>Company and Business</b>  | <b>Type of Investment</b>   | <b>(b)<br/>Date</b> | <b>(c)<br/>Equity</b> | <b>Cost</b> | <b>(d)<br/>Value</b> | <b>Per<br/>Share<br/>of<br/>Rand</b> |
|--|---|---------------------|-----------------------|-------------|----------------------|--------------------------------------|
| <b>Photonic Products Group, Inc (OTC:PHPG.OB) (i)</b><br>Northvale, NJ. Develops and manufactures products for laser photonics industry.<br>www.inrad.com  | 100 shares convertible Series B preferred stock, 10% dividend.<br>(a) 22,000 shares common stock.   | 10/31/00            | <1%                   | 155,000     | 138,500              | .02                                  |
| <b>RAMSCO (e)(g)(h)</b><br>Albany, NY. Distributor of water, sanitary, storm sewer and specialty construction materials to the contractor, highway and municipal construction markets.<br>www.ramsco.com                 | \$916,947.23 notes at 13% due November 18, 2007. Warrants to purchase 12.5% of common shares.   | 11/19/02            | 13%                   | 793,644     | 793,644              | .14                                  |
| <b>Rocket Broadband Networks, Inc. (g)</b><br>Rochester, NY.<br>Communications service provider of satellite TV, broadband internet and VoIP digital phone targeting multiple dwelling units.<br>www.rocketbroadband.com | 533,827 Series A-1 Preferred shares.  | 12/20/05            | 8%                    | 400,000     | 400,000              | .07                                  |
| <b>Somerset Gas Transmission Company, LLC</b><br>Columbus, OH. Natural gas transportation company.<br>www.somersetgas.com  | 26.5337 Units.  | 7/10/02             | 2%                    | 719,097     | 786,748              | .14                                  |
| <b>Synacor Inc. (e)(g)</b><br>Buffalo, NY. Develops provisioning platforms for aggregation and delivery of content for broadband access providers.<br>www.synacor.com  | 200,000 shares of Series B preferred stock. 78,186 Series A preferred shares. 80,126 Series C preferred shares. Warrants for 299,146 common shares. | 11/18/02            | 4%                    | 999,478     | 3,818,000            | .67                                  |

|  |  |          |     |               |               |     |
|--|--|----------|-----|---------------|---------------|-----|
| <b>Topps Meat Company LLC (e)(g)</b><br>Elizabeth, NJ. Producer and supplier of premium branded frozen hamburgers and other portion controlled meat products.<br>www.toppsmeat.com | Preferred A and Class A common membership interest.  | 4/3/03   | 3%  | 595,000       | 927,000       | .16 |
| <b>Ultra Scan Corporation</b><br>Amherst, NY. Biometrics application developer of ultrasonic fingerprint technology.<br>www.ultra-scan.com   | 536,596 common shares, 107,104 Series A-1 preferred shares.<br>(g) 95,284 Series A-1 preferred shares.   | 12/11/92 | 4%  | 938,164       | 1,203,000     | .21 |
| <b>Ustec, Inc.</b><br>Victor, NY. Markets digital wiring systems for new home construction.<br>www.ustecnet.com  | \$100,000 note at 5% due February 1, 2007.<br>50,000 common shares. Warrants for 139,395 common shares.  | 6/26/98  | <1% | 100,500       | 0             | .00 |
| <b>Wineisit.Com, Corp. (e)</b><br>Amherst, NY. Marketing company specializing in customer loyalty programs supporting the wine and spirit industry.<br>www.wineisit.com            | \$20,000 note at 12% due April 26, 2007.<br>(g) \$500,000 Senior Subordinated note at 10% due December 17, 2009. \$250,000 note at 10% due April 16, 2005. Warrants to purchase 100,000 shares Class B common stock. | 12/18/02 | 2%  | 821,918       | 100,000       | .02 |
| Other Investments  | Various  |          |     | 517,343       | 31,333        | .02 |
|  | Total portfolio investments  |          |     | \$ 13,126,870 | \$ 22,852,516 |     |

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**Rand Capital Corporation and Subsidiaries**  
**Condensed Consolidated Schedule of Portfolio Investments**  
**March 31, 2007 (Continued)**  
**(Unaudited)**

**Notes to Consolidated Schedule of Portfolio Investments**

- (a) Unrestricted securities are freely marketable securities having readily available market quotations. All other securities are restricted securities, which are subject to one or more restrictions on resale and are not freely marketable. At March 31, 2007 restricted securities represented 99% of the value of the investment portfolio. Freed Maxick & Battaglia, CPA's PC has not examined the business descriptions of the portfolio companies.
- (b) The Date Acquired column indicates the year in which the Corporation acquired its first investment in the company or a predecessor company.
- (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 its warrants or conversion of debentures, or other available data. Freed Maxick & Battaglia, CPA's, PC has not audited the equity percentages of the portfolio companies. The symbol <1% indicates that the Corporation holds equity interest of less than one percent.
- (d) The Corporation has adopted the SBA's valuation guidelines for SBIC's which describes the policies and procedures used in valuing investments. Under the valuation policy of the Corporation, unrestricted securities are valued at the closing price for publicly held securities for the last three days of the month. Restricted securities, including securities of publicly-held companies that are subject to restrictions on resale, are valued at fair 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 it is 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 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 portfolio company. 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 income producing. All other investments are non-income producing. Income producing investments have generated cash payments of interest or dividends within the last twelve months.
- (f) Income Tax Information As of March 31, 2007, the aggregate cost of investment securities approximated \$13.1 million. Net unrealized appreciation was approximately \$9.7 million of which \$11.5 million related to appreciated investment securities and \$1.8 million related to depreciated investment securities
- (g) Rand Capital SBIC, L.P. investment.
- (h) Reduction in cost and value reflects current principal repayment.
- (i) Publicly owned company.
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**Rand Capital Corporation and Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
**For the Three Months Ended March 31, 2007 and 2006**  
**(Unaudited)**

**Note 1. ORGANIZATION**

Rand Capital Corporation ( Rand or Corporation ) was incorporated under the laws of the state of New York on February 24, 1969. Commencing in 1971, Rand operated as a publicly traded, closed-end, diversified management company that was registered under Section 8(b) of the Investment Company Act of 1940 (the 1940 Act ). On August 16, 2001, Rand filed an election to be treated as a business development company ( BDC ) under the 1940 Act, which became effective on the date of filing. A BDC is a specialized type of investment company that is primarily engaged in the business of furnishing capital and managerial expertise to companies that do not have ready access to capital through conventional finance channels. There was no impact on the corporate structure as a result of the change to a BDC. Rand continues to operate as a publicly held venture capital company, listed on the NASDAQ Capital Market tier of the NASDAQ Stock Market under the symbol RAND.

**Formation of SBIC Subsidiary**

On January 16, 2002, Rand formed a wholly owned subsidiary, Rand Capital SBIC, L.P., ( Rand SBIC ) for the purpose of operating it as a small business investment company. At the same time, Rand organized another wholly owned subsidiary, Rand Capital Management, LLC ( Rand Management ), as a Delaware limited liability company, to act as the general partner of Rand SBIC. Rand transferred \$5 million in cash to Rand SBIC to serve as regulatory capital in January 2002, and on August 16, 2002 Rand received notification that its Small Business Investment Company (SBIC) application and license had been approved by the Small Business Administration (SBA). The approval allows Rand SBIC to obtain loans up to two times its initial \$5 million of regulatory capital from the SBA for purposes of making new investments in portfolio companies.

The following discussion includes Rand, Rand SBIC and Rand Management (collectively, the Corporation ).

The Corporation paid \$100,000 to the SBA to reserve \$10,000,000 of its approved debenture leverage. The leverage commitment expires on September 30, 2008. This fee was 1% of the face amount of the leverage reserved under the commitment and represents a partial prepayment of the SBA's nonrefundable 3% leverage fee. As of March 31, 2007, Rand SBIC had drawn \$8,100,000 in leverage from the SBA.

SBA debentures are issued with 10-year maturities. Interest only is payable semi-annually until maturity. Ten-year SBA debentures may be prepaid with a penalty during the first 5 years, and then are pre-payable without penalty. Rand initially capitalized Rand SBIC with \$5 million in regulatory capital. Rand SBIC was approved to obtain SBA leverage at a 2:1 matching ratio, resulting in a total capital pool eligible for investment of \$15 million. The Corporation expects to use Rand SBIC as its primary investment vehicle.

The Corporation formed Rand SBIC as a subsidiary for the purpose of causing it to be licensed as a SBIC under the Small Business Investment Act of 1958 (the SBA Act ) by the SBA, in order to have access to various forms of leverage provided by the SBA to SBIC's.

On May 28, 2002, the Corporation filed an Exemption Application with the SEC seeking an order under Sections 6(c), 12(d)(1)(J), 57(c), and 57(i) of, and Rule 17d-1 under, the 1940 Act for exemptions

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from the application of Sections 2(a)(3), 2(a)(19), 12(d)(1), 18(a), 21(b), 57(a)(1), (2), (3), and (4), and 61(a) of the 1940 Act to certain aspects of its operations. The application also seeks 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 applications seek orders that would permit:

a BDC (Rand) to operate a BDC/small business investment company (Rand SBIC) as its wholly owned subsidiary in limited partnership form;

Rand, Rand Management and Rand SBIC to engage in certain 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;

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 reports.

Since the filing of its original Application for Exemption, Rand has maintained discussions with the staff of the Division of Investment Management of the SEC concerning Rand's application. The principal substantive issue in these discussions has been the structure of Rand SBIC as a limited partnership. Rand SBIC must meet the requirements of the SBA for licensed SBICs, and at the same time Rand SBIC must meet the requirements of the SEC that apply to BDCs.

Rand formed Rand 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, and Rand formed Rand SBIC 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 is Rand Management, a limited liability company whose managers are the principal executive officers of Rand.

Under the rules and interpretations of the SEC applicable to BDCs, 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, and all of the persons who serve on the board of directors must be natural persons and a majority of them must not be interested persons of the BDC. Since the managers of Rand Management are the principal executive officers of Rand, and since both Rand Management and Rand SBIC are wholly owned by Rand, Rand believes that the Board of Directors of Rand is the functional equivalent of a board of directors for both Rand Management and Rand SBIC. Nevertheless, the staff of the Division of Investment Management of the SEC has expressed the view that if Rand SBIC is to be operated as a limited partnership BDC in compliance with the 1940 Act, then the organizational documents of Rand SBIC must specifically provide that it will have a board of directors consisting of natural persons, a majority of whom are not interested persons.

In discussions between Rand and the SBA, the SBA has recently indicated that if Rand SBIC is reorganized as a corporation whose directors are directors of Rand, it will continue to permit Rand SBIC to be licensed as an SBIC. Accordingly, Rand is currently in negotiations with the SEC and the SBA concerning the reorganization of Rand SBIC as a wholly owned corporate subsidiary of Rand whose board of directors will be comprised of directors of Rand, a majority of whom will not be interested persons of Rand or Rand SBIC, and concerning the licensing of the new corporate subsidiary as an SBIC. Based on the current status of these negotiations, Rand does not expect that either the reorganization process or the subsequent operations of Rand SBIC as a corporation will result in any material change in the operations of Rand SBIC. Once the reorganization is completed, Rand expects to



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make an appropriate amendment to its Exemption Application to the SEC, and it believes that it will receive exemptions necessary for its operation of Rand SBIC as a BDC.

Rand operates Rand SBIC through Rand Management for the same investment purposes, and with investments in similar kinds of securities, as Rand. Rand SBIC's operations are consolidated with those of Rand for both financial reporting and tax purposes.

**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 period ending March 31, 2007 are not necessarily indicative of the results for the full year.

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, 2006. Information contained in this filing should also be reviewed in conjunction with the Corporation's related filings with the SEC during the period of time prior to the date of this report. Those filings include, but are not limited to the following:

|              |  |
|--------------|--|
| N-30-B2/ARS  | Quarterly & Annual Reports to Shareholders   |
| 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, 2006  |
| Form 10-Q    | Quarterly Report on Form 10-Q for the quarters ended September 30, 2006, June 30, 2006, and March 31, 2006 |
| Form N-23C-1 | Reports by closed-end investment companies of purchases of their own securities                            |

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 committees and other reports filed with the SEC are available through the Corporation's website.

**Principles of Consolidation** The consolidated financial statements include the accounts of Rand, Rand SBIC and Rand Management, collectively, the Corporation. All intercompany accounts and transactions have been eliminated in consolidation.

**Investments** Investments are stated at fair value as determined in good faith by the Board of Directors, as described in the Notes to Consolidated Schedule of Portfolio Investments. Certain investment valuations have been determined by the Board of Directors in the absence of readily ascertainable fair values. The estimated valuations 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.

Amounts reported as realized gains and losses are measured by the difference between the net proceeds of sale or exchange and the cost basis of the investment without regard to unrealized gains or losses reported in prior periods. The cost of securities that have, in the Board of Directors' judgment, become worthless, are written off and reported as realized losses.

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**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 Investments 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 utilizes other qualitative and quantitative measures to determine the value of a portfolio investment and the collectability of any accrued interest.

**Original Issue Discount** Investments may create original issue discount or OID income. This situation arises when the Corporation purchases a warrant and a note from a portfolio company simultaneously. The transaction requires 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 then reported net of the OID which, is amortized into interest income over the life of the loan. The Corporation had one OID during the quarter ended March 31, 2007 that was fully amortized into income during the quarter due to the fact that the underlying debt instrument was paid in full. The OID amortized into income during the quarter was \$62,333.

**Deferred Debenture Costs** SBA debenture origination and commitment costs, which are included in other assets, will be amortized ratably over the terms of the SBA debentures. Amortization expense was \$6,996 for the three months ended March 31, 2007, compared to \$6,208 for the three months ended March 31, 2006.

**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 during the three months ended March 31, 2007 and 2006 amounted to \$508,222 and \$9,822, respectively. Interest paid during the three months ended March 31, 2007 and 2006 amounted to \$230,103 and \$172,965, respectively. During the three months ended March 31, 2007 and 2006, the Corporation converted \$40,000 and \$2,877, respectively, of interest receivable into equity investments.

**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 March 31, 2007 and December 31, 2006, 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 5% of the Corporation's outstanding stock on the open market through October 26, 2007. During the three month periods ended March 31, 2007 and 2006 the Corporation did not purchase any shares for the treasury.

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***Stock Option Plan*** In July 2001, the stockholders of the Corporation authorized the establishment of an Employee Stock Option Plan (the Plan). The Plan provides for the award of options to purchase up to 200,000 common shares to eligible employees. In 2002, the Corporation placed the Plan on inactive status as it developed a new profit sharing plan for the Corporation's employees in connection with the establishment of its SBIC subsidiary. As of March 31, 2007 and 2006, no stock options had been awarded under the 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 Plan while any profit sharing plan is in effect with respect to the Corporation.

***Uncertain Tax Positions*** Effective January 1, 2007, the Corporation adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109 (FIN 48). FIN 48 clarifies the accounting and disclosure for uncertain tax positions by requiring that a tax position 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 either a reduction of a current or deferred tax asset or receivable, or the recording of a current or deferred tax liability. FIN 48 also provides guidance on measurement, recognition of tax benefits, classification, interim period accounting disclosure, and transition requirements in accounting for uncertain tax positions.

The cumulative effect of adopting FIN 48 was to increase current taxes payable by \$21,200 and reduce deferred tax liabilities by \$316,253. As of January 1, 2007 the balance of accumulated net investment loss was decreased by \$11,016, and the balance in net unrealized appreciation on investments was increased by \$327,269. Upon adoption, the liability for income taxes associated with uncertain tax positions at January 1, 2007 was \$21,200 which if recognized would impact the Corporation's effective tax rate. The Corporation does not expect that the amounts of unrecognized tax positions will change significantly within the next 12 months.

It is the Corporation's policy to include interest and penalties related to income tax liabilities in income tax expense. There was no accrued interest or penalties recorded in the Consolidated Balance Sheet at January 1, 2007.

The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ending December 31, 2003 through 2006. The Company and its subsidiaries state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2003 through 2006.

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**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 our financial condition and results of operations in conjunction with our 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 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 Corporation 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 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 in Part II, Item 1A of this report, the text of which is incorporated herein by reference.*

*There may be other factors that we have not identified that affect the likelihood that the forward-looking statements may prove to be accurate. Further, any forward-looking statement speaks only as of the date it is made and, except as required by law, we undertake 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 our business not to develop as we expect, and we cannot predict all of them.*

**Overview**

The following discussion includes Rand Capital Corporation ( Rand ), Rand Capital SBIC, L.P., ( Rand SBIC ), and Rand Capital Management, LLC ( Rand Management ), (collectively the Corporation ), its financial position and results of operations.

Rand is incorporated under the laws of New York and is regulated under the 1940 Act as a business development company ( BDC ). In addition, a wholly-owned subsidiary, Rand SBIC is regulated as a Small Business Investment Company ( SBIC ) by the Small Business Administration ( SBA ). The Corporation anticipates that most, if not all, of its investments in the next year will be originated through the SBIC subsidiary.

**Critical Accounting Policies**

The Corporation prepares its consolidated financial statements in accordance with U.S. generally accepted accounting principles (GAAP) which requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities. A summary of our critical accounting policies can be found in the December 31, 2006 Form 10-K in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations .

**Table of Contents****Financial Condition**

Overview:

|                   | <b>3/31/07</b> | <b>12/31/06</b> | <b>Increase<br/>(Decrease)</b> | <b>%<br/>Increase<br/>(Decrease)</b> |
|-------------------|----------------|-----------------|--------------------------------|--------------------------------------|
| Total assets      | \$28,886,751   | \$29,463,944    | (\$577,193)                    | (2.0%)                               |
| Total liabilities | 11,656,625     | 12,681,539      | (1,024,914)                    | (8.1%)                               |
| Net assets        | \$17,230,126   | \$16,782,405    | \$ 447,721                     | 2.7%                                 |

The Corporation's financial condition is dependent on the success of its portfolio holdings. It has invested a substantial portion of its assets in small to medium sized private companies. The following summarizes the Corporation's investment portfolio at the period-ends indicated.

|                              | <b>3/31/07</b> | <b>12/31/06</b> | <b>Increase<br/>(Decrease)</b> | <b>%<br/>Increase<br/>(Decrease)</b> |
|------------------------------|----------------|-----------------|--------------------------------|--------------------------------------|
| Investments, at cost         | \$13,126,870   | \$14,033,789    | (\$906,919)                    | (6.5%)                               |
| Unrealized appreciation, net | 9,725,646      | 9,616,025       | 109,621                        | 1.1%                                 |
| Investments at fair value    | \$22,852,516   | \$23,649,814    | (\$797,298)                    | (3.4%)                               |

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

| <b>Changes to investments:</b>  | <b>Amount</b>     |
|---|-------------------|
| Adampluseve, Inc. (Adampluseve) warrant amortization                                | \$ 62,333         |
| Niagara Dispensing Technologies, Inc. (Niagara Dispensing) interest conversion      | 40,000            |
| <b>Total of changes in investments during the three months ended March 31, 2007</b> | <b>\$ 102,333</b> |

**Sales/Investment Repayments**

|  |           |
|--|-----------|
| Adampluseve                              | (561,000) |
| UStec, Inc. (UStec)                      | (350,000) |
| New Monarch Machine Tool, Inc. (Monarch) | (41,330)  |
| Ramsco                                   | (25,784)  |
| APF Group, Inc. (APF)                    | (15,528)  |
| Gemcor II, LLC (Gemcor)                  | (13,944)  |
| Takeform                                 | (1,666)   |

**Total of sales or investment repayments during the three months ended March 31, 2007** (1,009,252)

**Total change in investment balance, at cost during the three months ended March 31, 2007** (\$906,919)

Net asset value per share (NAV) was \$3.01/share at March 31, 2007 versus \$2.93/share at December 31, 2006.

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The Corporation's total investments at fair value, whose fair value have been estimated by the Board of Directors, approximated 133% of net assets at March 31, 2007 and 141% of net assets at December 31, 2006.

Cash and cash equivalents approximated 25% of net assets at March 31, 2007 compared to 26% at December 31, 2006.

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**Table of Contents****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 our 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.

***Comparison of the three months ended March 31, 2007 to the three months ended March 31, 2006***

|                                      | <b>March<br/>31, 2007</b> | <b>March 31,<br/>2006</b> | <b>Increase<br/>(Decrease)</b> | <b>% Increase<br/>(Decrease)</b> |
|--------------------------------------|---------------------------|---------------------------|--------------------------------|----------------------------------|
| Interest from portfolio companies    | \$ 199,717                | \$ 172,020                | \$ 27,697                      | 16.1%                            |
| Interest from other investments      | 46,047                    | 5,143                     | 40,904                         | 795.3%                           |
| Dividend and other investment income | 229,420                   | 13,135                    | 216,285                        | 1,646.6%                         |
| Other income                         | 5,228                     | 10,947                    | (5,719)                        | (52.2%)                          |
| Total investment income              | \$ 480,412                | \$ 201,245                | \$ 279,167                     | 138.7%                           |

**Interest from portfolio companies** Portfolio interest income increased \$27,697 or 16.1% during the three months ended March 31, 2007 as compared to the same period in the prior year. This increase is attributable to the fact that Adampluseve paid off its debenture instrument early and therefore the remaining \$62,333 in unamortized Original Issue Discount (OID) was accreted into income. OID income is created when the Corporation invests in a debenture instrument that has a warrant attached to the instrument. This transaction requires an allocation of a portion of the investment price to the warrant and reduces the debt instrument by an equal amount in the form of a note discount or OID. The note is then reported net of the discount and the discount is accreted into income over the life of the debenture instrument.

The increase attributed to OID income was offset by a decrease in portfolio interest revenue due to the fact that four debenture instruments (Concentrix Corporation (Concentrix), Innov-X Systems, Inc.(Innov-X), UStec and Synacor Inc (Synacor)) that contributed to portfolio interest income in the first quarter of 2006 were either repaid or converted into equity instruments during the last three quarters of 2006 and the first quarter of 2007 thereby reducing portfolio interest income during the first quarter of 2007.

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

| Company           | Interest<br>Rate | Investment<br>Cost | Year that<br>Interest<br>Accrual Ceased |
|-------------------|------------------|--------------------|---|
| Contract Staffing | 5%               | \$ 141,400         | 2006                                    |
| G-Tec             | 8%               | 400,000            | 2004                                    |
| UStec             | 5%               | 100,000            | 2006                                    |
| WineIsIt.com      | 10%              | 821,918            | 2005                                    |

**Interest from other investments** The increase in interest income is primarily due to higher yields on idle cash balances and the fact that the cash balance is approximately \$3,425,000 higher at March 31, 2007 than at March 31, 2006.





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**Dividend and other investment income** Dividend income is comprised of distributions from Limited Liability Companies (LLCs) that the Corporation has invested in. The Corporation's investment agreements with certain LLCs require the entities to distribute funds to the Corporation for payment of income taxes on its allocable share of the entities' profits. These dividends will fluctuate based upon the profitability of the entities and the timing of the distributions. Dividend income for the three months ended March 31, 2007 consisted of distributions from Gemcor II, LLC (Gemcor) for \$204,051, Topps Meat Company LLC (Topps) for \$12,545 and Carolina Skiff LLC (Carolina Skiff) for \$12,824. Dividend income for the three months ended March 31, 2006 consisted of distributions from Topps for \$5,302 and Gemcor for \$7,833.

**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 financing. The SBA regulations limit the amount of fees that can be charged to a portfolio company and the Corporation typically charges 1% to 3% to the portfolio concerns. These fees are amortized ratably over the life of the instrument associated with the fees. Upon the prepayment of a loan or debt security, any unamortized closing fees are recorded as income. The unamortized fees are carried on the balance sheet under Deferred Revenue. In addition, other income includes fees charged by the Corporation to its portfolio companies for attendance at the portfolio company board meetings.

Other income decreased slightly due to the fact that the Corporation only charged two portfolio companies closing fees in 2006. The annualized financing fee income based on the existing portfolio will be approximately \$21,000 annually in 2007 and less than \$10,000 annually thereafter.

**Operating Expenses**

|                | <b>March 31,<br/>2007</b> | <b>March 31,<br/>2006</b> | <b>Increase</b> | <b>%<br/>Increase</b> |
|----------------|---------------------------|---------------------------|-----------------|-----------------------|
| Total Expenses | \$ 379,579                | \$ 327,845                | \$51,734        | 16%                   |

Operating expenses predominately consist of interest expense on SBA obligations, employee compensation and benefits, directors' fees, shareholder related costs, office expenses, professional fees, and expenses related to identifying and reviewing investment opportunities.

The increase in operating expenses during the three months ended March 31, 2007 can be attributed to the 18% or \$18,842 increase in SBA interest expense. The Corporation has borrowed \$8,100,000 from the SBA as of March 31, 2007 at an average borrowing rate, including surcharges, of approximately 5.9%. The Corporation expects that interest costs will continue to increase in 2007 and beyond as it continues to draw down SBA leverage up to the maximum approved leverage of \$10 million. The Corporation anticipates that the remaining SBA leverage of \$1,900,000 will be drawn down in 2008. This interest is paid on a semi-annual basis.

In addition, salaries expense increased 11% or \$10,686 from \$96,284 for the three months ended March 31, 2006 to \$106,970 for the three months ended March 31, 2007. Benefit expense also increased by 33% or \$10,387 from \$31,926 for the three months ended March 31, 2006 to \$42,313 for the three months ended March 31, 2007. These increases are due to salary increases and increases in benefit rates. Professional fees were \$31,678 and \$26,536 for the three months ended March 31, 2007 and 2006, respectively. This increase of 19% or \$5,142 can be attributed to the growth of the Corporation's investment portfolio and the proposed restructuring of the corporate structure to comply with certain SBA regulations that were discussed in Note 1 Organization. The Corporation expects legal fees to continue to increase until the reorganization is finalized in 2007.

**Table of Contents****Net Realized Gains and Losses on Investments**

During the three months ended March 31, 2007, the Corporation recognized a net realized loss of (\$39,236) as UStec satisfied its \$350,000 debenture instrument obligation by a payment in the amount of \$310,764. During the three months ended March 31 2006, the Corporation recognized a net realized gain of \$187,953 on its sale of 290,000 shares of Minrad International Inc. (Minrad). The average sales price of Minrad was \$2.05/share and the basis of the stock was \$1.36/share. The Corporation incurred \$14,500 in broker transaction fees that were netted against the realized gain

**Net Change in Unrealized Appreciation (Depreciation) of Investments**

The Corporation recorded a net increase in unrealized appreciation on investments of \$109,621 during the three months ended March 31, 2007, as compared to an increase of \$247,277 during the three months ended March 31, 2006. The increase in unrealized appreciation on investments of \$109,621 is due to the following valuation changes made by the Corporation:

|   | <b>March 31,<br/>2007</b> |
|---|---------------------------|
| Adampluseve warrants  | \$ 65,341                 |
| Reclass UStec to realized loss  | 39,000                    |
| Photonics valuation to market   | 5,280                     |
| <b>Total increase in net unrealized appreciation during the three months ended March 31, 2007</b> | <b>\$ 109,621</b>         |

The Corporation recognized appreciation on its remaining equity investment in Adampluseve. The portfolio company participated in a round of financing in January 2007 that caused them to pay off the Corporation's debenture instrument prior to the maturity date. The Corporation still holds warrants in Adampluseve and they were adjusted based on the pricing of this recent round of financing.

Photonics is a publicly traded stock (Nasdaq symbol: PHPG.OB) and is marked to market at the end of each quarter.

The Corporation recorded a net decrease in unrealized depreciation on investments of \$247,277 during the three months ended March 31, 2006. The decrease in unrealized depreciation on investments of \$247,277 is due to the following valuation changes made by the Corporation:

|   | <b>March 31,<br/>2006</b> |
|---|---------------------------|
| Minrad valuation to market  | \$ 329,453                |
| Photonics valuation to market   | 2,880                     |
| Reclass Minrad unrealized gain to realized gain on shares sold                                    | (85,056)                  |
| <b>Total decrease in net unrealized depreciation during the three months ended March 31, 2006</b> | <b>\$ 247,277</b>         |

As a result of the stock sale, the Corporation recognized appreciation of \$329,453 on its 387,981 remaining shares of Minrad.

All of these value adjustments are consistent with the Corporation's established valuation policy.

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**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 three months ended March 31, 2007, the net increase in net assets from operations was \$131,468 as compared to a net increase in net assets from operations of \$193,630 for the same three month period in 2006. The increase for the period ending March 31, 2007 is attributed to an increase in net investment gain of \$101,204 which is due to improved investment income from the Corporation's portfolio investments.

**Liquidity and Capital Resources**

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 provide a current return on a portion of the investment portfolio. The equity features contained in our investment portfolio are structured to realize capital appreciation over the long-term and may not necessarily generate current income in the form of dividends or interest.

As of March 31, 2007, the Corporation's total liquidity, consisting of cash and cash equivalents, was \$4,215,573.

As of March 31, 2007 the Corporation had paid \$100,000 to the SBA to reserve its approved \$10,000,000 leverage. This leverage commitment expires on September 30, 2008. The Corporation has drawn down \$8,100,000 of this leverage as of March 31, 2007. These SBA borrowings will have balloon maturities beginning in 2014. Management expects that it will not be necessary to draw down the SBA leverage for the remainder of 2007, and that the large cash balance will be adequate to fund new investments and operating activities. The Corporation anticipates that the remaining \$1,900,000 in SBA leverage will be drawn down in fiscal year 2008 prior to the expiration of the commitment and will be available to fund operations and new investments.

Management believes that the cash and cash equivalents at March 31, 2007, coupled with the anticipated additional SBIC leverage draw downs and interest and dividend payments on its portfolio investments, will provide the Corporation with the liquidity necessary to fund operations and new investments over the next twelve months. The Corporation expects its cash flow related to its investing activities will continue to fluctuate based on its success in originating investments and its ability to realize gains on liquidation of investments.

**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 equity-linked 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 Board of Directors in accordance with the Corporation's investment valuation policy. (The discussion of valuation policy contained in Item 1 Financial Statements and Supplementary Data in the Notes to Consolidated Schedule of Portfolio Investments and is hereby incorporated herein by reference.) In the absence of a readily ascertainable market value, 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 change in unrealized appreciation (depreciation).

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At times, a portion of the Corporation's portfolio may include marketable securities traded in the over-the-counter market. In addition, there may be a portion of 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 the 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 March 31, 2007 the Corporation did not have any off-balance sheet investments or hedging investments.

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**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our principal executive officer and principal financial officer have concluded that as of such date, our disclosure controls and procedures were designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable SEC rules and forms and were effective.

*Changes in Internal Control Over Financial Reporting.* There have been no significant changes in our internal control identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**PART II.  
OTHER INFORMATION**

**Item 1. Legal Proceedings**

None

**Item 1A. Risk Factors**

**The Corporation is Subject to Risks Created by the Valuation of its Portfolio Investments**

There is typically no public market for equity securities of the small privately held companies in which the Corporation invests. As a result, the valuations of the equity securities in the Corporation's portfolio are stated at fair value as determined by the good faith estimate of the Corporation's Board of Directors in accordance with the established SBA valuation policy. In the absence of a readily ascertainable market value, the estimated value of the Corporation's portfolio of securities may differ significantly, favorably or unfavorably, 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 the statement of operations as Net change in unrealized appreciation (depreciation).

**The Corporation's Portfolio Investments are Illiquid**

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

**Investing in Private Companies involves a High Degree of Risk**

The Corporation typically invests a substantial portion of its assets in small and medium sized private companies. These private businesses may be thinly capitalized, unproven companies with risky technologies and may lack management depth and have not attained profitability. 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. The Corporation 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. The Corporation has been risk seeking rather than risk averse in its approach to venture capital and other investments. Neither the Corporation's investments nor an investment in the Corporation is intended to constitute a balanced investment program.

Even if the Corporation'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 the portfolio companies may not be successful.

**Investing in The Corporation's Shares May be Inappropriate for the Investor's Risk Tolerance**

The Corporation'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. The Corporation's investments in portfolio companies are highly speculative and aggressive

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and, therefore, an investment in its shares may not be suitable for investors for whom such risk is inappropriate.

**The Corporation is Subject to Risks Created by its Regulated Environment**

The Corporation is regulated by the SBA and the SEC. Changes in the laws or regulations that govern SBICs and BDCs could significantly affect the Corporation's business. Regulations and laws may be changed periodically, and the interpretations of the relevant regulations and laws are also subject to change. Any change in the regulations and laws governing the Corporation's business could have a material impact on its financial condition or its results of operations.

**The Corporation is Subject to Risks Created by Borrowing Funds from the SBA**

The Corporation's Leverageable Capital may include large amounts of debt securities issued through the SBA, and all of the debentures will have fixed interest rates. Until and unless the Corporation is able to invest substantially all of the proceeds from debentures at annualized interest or other rates of return that substantially exceed annualized interest rates that Rand SBIC must pay the SBA, the Corporation's operating results may be adversely affected which may, in turn, depress the market price of the Corporation's common stock.

**The Corporation is Dependent Upon Key Management Personnel for Future Success**

The Corporation is dependent for the selection, structuring, closing and monitoring of its investments on the diligence and skill of its two senior officers, Allen F. Grum and Daniel P. Penberthy. The future success of the Corporation depends to a significant extent on the continued service and coordination of its senior officers. The departure of either of its senior officers could materially adversely affect its ability to implement its business strategy. The Corporation does not maintain key man life insurance on any of its officers or employees.

**The Corporation Operates in a Competitive Market for Investment Opportunities**

The Corporation faces competition in its investing activities from many entities including other SBICs, private venture capital funds, investment affiliates of large companies, wealthy individuals and other domestic or foreign investors. The competition is not limited to entities that operate in the same geographical area as the Corporation. As a regulated BDC, the Corporation is required to disclose quarterly and annually the name and business description of portfolio companies and the value of its portfolio securities. Most of its competitors are not subject to this disclosure requirement. The Corporation's obligation to disclose this information could hinder its ability to invest in certain portfolio companies. Additionally, other regulations, current and future, may make the Corporation less attractive as a potential investor to a given portfolio company than a private venture capital fund.

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

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

None

**Item 3. Defaults upon Senior Securities**

None

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

None

**Item 5. Other Information**

None

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**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.
- (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.
- (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.
- (10.1) Employee Stock Option Plan incorporated by reference to Appendix B to the Corporation's definitive Proxy Statement filed on June 1, 2002.\*
- (10.3) Agreement of Limited Partnership for Rand Capital SBIC, L.P. incorporated by reference to Exhibit 10.3 to the Corporation's Form 10-K filed for the year ended December 31, 2001.
- (10.4) Certificate of Limited Partnership of Rand Capital SBIC, L.P. incorporated by reference to Exhibit 10.4 to the Corporation's Form 10-K filed for the year ended December 31, 2001.
- (10.5) Limited Liability Corporation Agreement of Rand Capital Management, LLC incorporated by reference to Exhibit 10.5 to the Corporation's Form 10-K Report filed for the year ended December 31, 2001.
- (10.6) Certificate of Formation of Rand Capital Management, LLC incorporated by reference to Exhibit 10.6 to the Corporation's Form 10-K Report filed for the year ended December 31, 2001.
- (10.7) N/A
- (10.8) Profit Sharing Plan incorporated by reference to Exhibit 10.8 to the Corporation's Form 10-K Report filed for the year ended December 31, 2002.\*
- (21) Subsidiaries of the Corporation incorporated by reference to Exhibit 21 to the Corporation's Form 10-K Report filed for the year ended December 31, 2001.
- (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 filed herewith

(32.2) Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Rand Capital SBIC, L.P. filed herewith

\* Management contract or compensatory plan.

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**Signatures**

**Pursuant to the requirements of Section 13 or 15(d) of Securities Exchange Act of 1934, the registrant has duly caused this Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.**

Dated: May 10, 2007

RAND CAPITAL CORPORATION

By: /s/ Allen F. Grum

Allen F. Grum, President

By: /s/ Daniel P. Penberthy

Daniel P. Penberthy, Treasurer

RAND CAPITAL SBIC, L.P.

By: RAND CAPITAL MANAGEMENT LLC  
General Partner

By: RAND CAPITAL CORPORATION  
Member

By: /s/ Allen F. Grum

Allen F. Grum, President

By: /s/ Daniel P. Penberthy

Daniel P. Penberthy, Treasurer