

RAND CAPITAL CORP  
Form 10-K  
March 15, 2012  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2011**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the Transition Period from                    to**

Commission File Number: 814-00235

**Rand Capital Corporation**

*(Exact name of registrant as specified in its charter)*

**New York**  
*(State or Other Jurisdiction of*

**16-0961359**  
*(IRS Employer Identification No.)*

*Incorporation or organization)*

**2200 Rand Building, Buffalo, NY**  
*(Address of Principal executive offices)*

**14203**  
*(Zip Code)*

**Registrant's telephone number, including area code): (716) 853-0802**

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

**Title of Each Class**  
**Common Stock, \$0.10 par value**

**Name of Exchange on Which Registered**  
**NASDAQ Capital 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 under the Securities Act. Yes  No

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

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 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 registrant's knowledge, in 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.

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

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

The aggregate market value of the registrant's outstanding common stock held by non-affiliates of the registrant as of June 30, 2011 was approximately \$17,738,010 based upon the last sale price as quoted by NASDAQ Capital Market on such date.

As of March 7, 2012 there were 6,818,934 shares of the registrant's common stock outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Corporation's definitive proxy statement for the Annual Meeting of Stockholders to be held on April 26, 2012 are incorporated by reference into Part III of this report.

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**PART I**

**Item 1. Business**

**Corporation Formation**

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

Throughout the Corporation s history, its principal business has been to make venture capital investments in small to medium sized companies that are engaged in the exploitation of new or unique products or services with a sustainable competitive advantage, typically in New York and its surrounding states. The Corporation s principal investment objective is to achieve long-term capital appreciation while maintaining a current cash flow from its debt instruments. The Corporation invests in a mixture of debt and equity instruments. The debt securities typically have an equity component in the form of stock, warrants, and options to acquire stock or the right to convert the debt securities into stock. Rand SBIC has been the primary investment vehicle since its formation and it is anticipated that will continue to be the case in 2012. Consistent with its status as a BDC and the purposes of the regulatory framework for BDC s under the 1940 Act, the Corporation provides managerial assistance, often in the form of a board of directors seat, to the portfolio companies in which it invests.

The Corporation operates as an internally managed investment company whereby its officers and employees conduct its operations under the general supervision of its Board of Directors. It has not elected to qualify to be taxed as a regulated investment company as defined under Subchapter M of the Internal Revenue Code.

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

The Corporation s website is [www.randcapital.com](http://www.randcapital.com). The Corporation s annual report on Form 10-K and its Proxy Statement are available at the following web address: <http://materials.proxyvote.com/752185>. In addition, the annual report on Form 10-K, the quarterly reports on Form 10-Q, current reports on Form 8-K, charters for the Corporation s committees and other reports filed with the Securities and Exchange Commission ( SEC ) are available through the Corporation s website.

**Regulation as a Business Development Company**

Although the 1940 Act exempts a BDC from registration under that Act, it contains significant limitations on the operations of BDCs. Among other things, the 1940 Act contains prohibitions and restrictions relating to transactions between a BDC and its affiliates, principal underwriters and affiliates of its affiliates or underwriters, and it requires that a majority of the BDC s directors be persons other than interested persons, as defined under the 1940 Act. The 1940 Act also prohibits a BDC from changing the nature of its business so as to cease to be, or to withdraw its election as, a BDC unless so authorized by a vote of the holders of a majority of its outstanding voting securities. BDC s are not required to maintain fundamental investment policies relating to diversification and concentration of investments within a single industry. More specifically, in order to qualify as a BDC, a company must:

(1) be a domestic company;

(2) have registered a class of its equity securities or have filed a registration statement with the SEC pursuant to Section 12 of the Securities Exchange Act of 1934;

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(3) operate for the purpose of investing in the securities of certain types of portfolio companies, namely immature or emerging companies and businesses suffering or just recovering from financial distress. Generally, a BDC must be primarily engaged in the business of furnishing capital and providing managerial expertise to companies that do not have ready access to capital through conventional financial channels. Such portfolio companies are termed eligible portfolio companies.

(4) extend significant managerial assistance to such portfolio companies; and

(5) have a majority of disinterested directors (as defined in the 1940 Act).

An eligible portfolio company is, generally, a private domestic operating company, or a public domestic operating company whose securities are not listed on a national securities exchange. In addition, any small business investment company that is licensed by the SBA and is a wholly owned subsidiary of a BDC is an eligible portfolio company.

The 1940 Act prohibits or restricts companies subject to the 1940 Act from investing in certain types of companies, such as brokerage firms, insurance companies, investment banking firms and investment companies. Moreover, the 1940 Act limits the type of assets that BDCs may acquire to qualifying assets and certain assets necessary for its operations (such as office furniture, equipment and facilities) if, at the time of acquisition, less than 70% of the value of the BDC's assets consist of qualifying assets. Qualifying assets include: (1) securities of companies that were eligible portfolio companies at the time the BDC acquired their securities; (2) securities of bankrupt or insolvent companies that were eligible at the time of the BDC's initial acquisition of their securities but are no longer eligible, provided that the BDC has maintained a substantial portion of its initial investment in those companies; (3) securities received in exchange for or distributed on or with respect to any of the foregoing; and (4) cash items, government securities and high-quality short-term debt. The 1940 Act also places restrictions on the nature of the transactions in which, and the persons from whom, securities can be purchased in order for the securities to be considered qualifying assets. These restrictions include limiting purchases to transactions not involving a public offering and not acquiring securities from the portfolio company or its officers, directors, or affiliates.

A BDC is permitted to invest in the securities of public companies and other investments that are not qualifying assets, but those kinds of investments may not exceed 30% of the BDC's total asset value at the time of the investment. At December 31, 2011 the Corporation was in compliance with this rule.

A BDC must make significant managerial assistance available to the issuers of eligible portfolio securities in which it invests. Making available significant managerial assistance means, among other things, any arrangement whereby the BDC, through its directors, officers or employees, offers to provide, and, if accepted does provide, significant guidance and counsel concerning the management, operations or business objectives and policies of a portfolio company.

## **SBIC Subsidiary**

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

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

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

Under the rules and interpretations of the SEC applicable to BDCs (which the subsidiary SBIC intended to become), if a BDC is structured in limited partnership form, then it must have general partners who serve as a board of directors, or a general partner with very limited authority and a separate board of directors, all of the persons who serve on the board of directors must be natural persons, and a majority of the directors must not be interested persons of the BDC. Since the managers of the limited liability company general partner of the SBIC subsidiary were the principal executive officers of Rand, and since both the limited liability company general partner and the subsidiary SBIC were wholly-owned by Rand, Rand believed that the board of directors of Rand was the functional equivalent of a board of directors for both the general partner limited liability company and for the SBIC limited partnership. Nevertheless, the staff of the Division of Investment Management of the SEC maintained the view that if the limited partnership subsidiary was to be operated as a limited partnership BDC in compliance with the 1940 Act, then the organizational documents of the limited partnership would have to specifically provide that it would have a board of directors consisting of natural persons, a majority of whom would not be interested persons.

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

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

Rand and Rand SBIC to engage in certain related party transactions that the Corporation would otherwise be permitted to engage in as a BDC if its component parts were organized as a single corporation;

Rand, as a BDC, and Rand SBIC, as its BDC/SBIC subsidiary, to meet asset coverage requirements for senior securities on a consolidated basis; and

Rand SBIC, as a BDC/SBIC subsidiary of Rand as a BDC, to file Exchange Act reports on a consolidated basis as part of Rand's Exchange Act reports.

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

Although Rand SBIC is operated as if it were a BDC, it is currently registered as an investment company under the 1940 Act. Now that the Corporation has received the order granting the exemptions described above, Rand SBIC will promptly file an election to be regulated as a BDC under the 1940 Act.

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### **Regulation of the SBIC Subsidiary**

#### ***SBA Lending Restrictions***

The SBA licenses SBICs as part of a program designed to stimulate the flow of private debt and/or equity capital to small businesses. SBICs use funds borrowed from the SBA, together with their own capital, to provide loans to, and make equity investments in, concerns that:

(a) have a tangible net worth not in excess of \$18 million and average net income after U.S. federal income taxes for the preceding two completed fiscal years not in excess of \$6 million, or

(b) meet size standards set by the SBA that are measured by either annual receipts or number of employees, depending on the industry in which the concerns are primarily engaged.

The types and dollar amounts of the loans and other investments an SBIC that is a BDC may make are limited by the 1940 Act, the SBA Act and SBA regulations. The SBA is authorized to examine the operations of SBICs, and an SBIC's ability to obtain funds from the SBA is also governed by SBA regulations.

In addition, at the end of each fiscal year, an SBIC must have at least 20% (in total dollars) invested in Smaller Enterprises. The SBA defines Smaller Enterprises as concerns that:

(a) do not have a net worth in excess of \$6 million and have average net income after U.S. federal income taxes for the preceding two years no greater than \$2 million, or

(b) meet size standards set by the SBA that are measured by either annual receipts or number of employees, depending on the industry in which the concerns are primarily engaged.

The Corporation complied with this requirement since the inception of the SBIC subsidiary.

SBICs may invest directly in the equity of portfolio companies, but they may not become a general partner of a non-incorporated entity or otherwise become jointly or severally liable for the general obligations of a non-incorporated entity. An SBIC may acquire options or warrants in portfolio companies, and the options or warrants may have redemption provisions, subject to certain restrictions.

#### ***SBA Leverage***

The SBA raises capital to enable it to provide funds to SBICs by guaranteeing certificates or bonds that are pooled and sold to purchasers of the government guaranteed securities. The amount of funds that the SBA may lend to SBICs is determined by annual Congressional appropriations.

To reserve the approved SBA debenture leverage the Corporation must pay an upfront 1% commitment fee to the SBA as a partial prepayment of the SBA's nonrefundable 3% leverage fee. These fees are then expensed over the life of the corresponding debenture instruments. The Corporation paid \$100,000 to reserve the original \$10,000,000 in SBA leverage. When this original SBA commitment expired in December 2008, Rand SBIC re-applied for the remaining \$1,900,000 in leverage and paid the SBA an additional commitment fee of \$19,000 to reserve this leverage. During 2011, the Corporation repaid \$6,000,000 in existing SBA leverage and contributed \$1,000,000 of Regulatory Capital into the Rand SBIC, Inc. subsidiary. Additionally, during 2011 the SBA approved \$8,000,000 in new SBA leverage and the Corporation paid the \$80,000 commitment fee to reserve this leverage. The total outstanding leverage was \$4,000,000 at December 31, 2011 and the total remaining SBA commitment at December 31, 2011 is \$8,000,000. This outstanding leverage commitment expires on September 30, 2016.

SBA debentures are issued with ten year maturities. Interest only is payable semi-annually until maturity. All of the Corporation's outstanding SBA debentures may be prepaid without penalty. Rand initially capitalized Rand SBIC with \$5,000,000 in Regulatory Capital and contributed another \$1,000,000 in Regulatory Capital to the SBIC subsidiary during 2011. Rand SBIC's Regulatory Capital totaled \$6,000,000 at December 31, 2011. Regulatory Capital is defined by the SBA as private capital, excluding non-cash assets, contributed to a SBIC licensee. The Corporation expects to use Rand SBIC as its primary investment vehicle.

### **Employees**

As of December 31, 2011, the Corporation had four employees.





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

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

At December 31, 2011 all of the Corporation's portfolio investments are private securities and are not publicly traded. There is typically no public market for securities of the small privately held companies in which the Corporation invests. Investments are valued in accordance with the Corporation's established valuation policy and are stated at fair value as determined in good faith by the management of the Corporation and submitted to the Board of Directors for approval. 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 securities existed. Any changes in estimated value are recorded in the statement of operations as Net increase (decrease) in unrealized appreciation.

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

Most of the investments of the Corporation are or will be either equity securities or subordinated debt securities acquired directly from small companies. The Corporation's portfolio of equity and debt securities is, and will usually be, subject to restrictions on resale and has no established trading market. The illiquidity of most of the Corporation's portfolio may adversely affect the ability of the Corporation to dispose of the securities at times when it may be advantageous for the Corporation to liquidate 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, may lack management depth, and may not have 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 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.

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 greater than average amount of risk and volatility and may result in loss of principal. Its investments in portfolio companies are highly speculative and aggressive and, therefore, an investment in its shares may not be suitable for investors for whom such risk is inappropriate. Neither the Corporation's investments nor an investment in the Corporation constitutes a balanced investment program.

#### ***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. Moreover, the laws and regulations that govern BDCs and SBICs may place conflicting demands on the manner in which the Corporation operates, and the resolution of those conflicts may restrict or otherwise adversely affect the operations of the Corporation.

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

The Corporation's liabilities may include large amounts of debt securities issued through the SBA which 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 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.

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

The Corporation is dependent on the skill, diligence, and the network of business contacts of its two senior officers, Allen F. Grum and Daniel P. Penberthy, for the selection, structuring, closing, monitoring and valuation of its investments. The future success of the Corporation depends to a significant extent on the continued service and coordination of its senior management. 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's Portfolio Has a Limited Number of Companies, and May be Subjected to Greater Risk if Any of These Companies Default***

The Corporation's portfolio investment values are concentrated in a small number of companies and as such, it may experience a significant loss in Net Asset Value if one or more of these companies perform poorly or go out of business. The unrealized or realized write down of any one of these companies would negatively impact the Corporation's Net Asset Value.

### ***The Corporation May be Negatively Affected by Adverse Changes in General Economic Conditions***

During the last several years the global economy experienced an economic downturn and this may continue to have an impact on the Corporation's portfolio companies and the overall financial condition of the Corporation. The portfolio companies may experience residual effects from this financial crisis and any future slowdowns or recessions and not be able to repay their debt instruments to the Corporation, which could have a material adverse effect on Net Asset Value of the Corporation.

### ***Fluctuations of Quarterly Results***

The Corporation's quarterly operating results could fluctuate significantly 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 quarter cannot be relied upon as being indicative of performance in future quarters.

**Table of Contents****Item 1B. Unresolved Staff Comments**

Not applicable.

**Item 2. Properties**

The Corporation maintains its offices at 2200 Rand Building, Buffalo, New York 14203, where it leases approximately 1,300 square feet of office space pursuant to a lease agreement that expires December 31, 2015. The Corporation believes that its leased facilities are adequate to support its current staff and expected future needs.

**Item 3. Legal Proceedings**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Part II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The Corporation's common stock, par value \$0.10 per share ( Common Stock ), is traded on the NASDAQ Capital Market ( NASDAQ ) under the symbol RAND. The following table sets forth, for the periods indicated, the range of high and low closing sales prices per share as reported by NASDAQ:

| <b>2011 Quarter ending:</b> | <b>High</b> | <b>Low</b> |
|-----------------------------|-------------|------------|
| March 31st                  | \$ 3.50     | \$ 2.81    |
| June 30th                   | \$ 3.00     | \$ 2.75    |
| September 30th              | \$ 3.05     | \$ 2.65    |
| December 31st               | \$ 3.12     | \$ 2.65    |
| <b>2010 Quarter ending:</b> | <b>High</b> | <b>Low</b> |
| March 31st                  | \$ 3.84     | \$ 3.20    |
| June 30th                   | \$ 3.77     | \$ 3.00    |
| September 30th              | \$ 3.39     | \$ 2.70    |
| December 31st               | \$ 3.80     | \$ 2.97    |

The Corporation has not paid any cash dividends in its most recent two fiscal years, and it has no intention of paying cash dividends in the 2012 fiscal year.

**Profit Sharing and Stock Option Plans**

In 2001 the stockholders of the Corporation authorized the establishment of an Employee Stock Option Plan (the Option Plan ). The Option Plan provides for the award of options to purchase up to 200,000 common shares to eligible employees. In 2002 the Corporation placed the Option Plan on inactive status as it developed a new profit sharing plan for the Corporation's employees in connection with the formation of its SBIC subsidiary. As of December 31, 2011, no stock options had been awarded under the Option Plan. Because Section 57(n) of the 1940 Act prohibits maintenance of a profit sharing plan for the officers and employees of a BDC where any option, warrant or right is outstanding under an executive compensation plan, no options will be granted under the Option Plan while any profit sharing plan is in effect with respect to the Corporation.



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In 2002 the Corporation established a Profit Sharing Plan (the Plan ) for its executive officers in accordance with Section 57(n) of the 1940 Act. Under the Plan, the Corporation will pay its executive officers aggregate profit sharing payments equal to 12% of the net realized capital gains of its SBIC subsidiary, net of all realized capital losses and unrealized depreciation of the SBIC subsidiary, for the fiscal year, computed in accordance with the Plan and the Corporation's interpretation of the Plan. Any profit sharing paid or accrued cannot exceed 20% of the Corporation's net income, as defined. The profit sharing payments will be split equally between the Corporation's two executive officers, each of whom are fully vested in the Plan. There were no amounts earned pursuant to the Plan for the year ended December 31, 2011. During the year ended December 31, 2010 the Corporation approved and accrued \$584,634 under the Plan, of which \$568,694 was paid during the year ended December 31, 2011. The remaining \$15,940 is related to an escrow receivable and will be paid when the escrow is collected. During the year ended December 31, 2009, the Corporation approved and accrued \$133,013 under the Plan, which was paid during the year ended December 31, 2010. The amounts approved do not exceed the defined limits.

**Shareholders of Record**

On March 7, 2012 the Corporation had a total of 837 shareholders, which included 106 record holders of its common stock, and an estimated 731 shareholders with shares beneficially owned in nominee name or under clearinghouse positions of brokerage firms or banks.

**Stock Repurchase Plan**

The Board of Directors has authorized the repurchase of up to 340,946 shares of the Corporation's outstanding Common Stock on the open market at prices that are no greater than current net asset value through October 28, 2012. During 2002 and 2003 the Corporation repurchased 44,100 shares of its Common Stock for a total cost of \$47,206. No additional shares have been repurchased since 2003.

**Table of Contents****Company Performance Graph**

The following graph shows a five-year comparison of cumulative total shareholder returns for the Company's Common Stock, the NASDAQ Market Index, and a Peer Group, assuming a base index of \$100 at the end of 2006. The cumulative total return for each annual period within the five years presented is measured by dividing (1) the sum of (A) the cumulative amount of dividends for the measurement period, assuming dividend investment, and (B) the difference between share prices at the end and at the beginning of the measurement period by (2) the share price at the beginning of the measurement period.

## Comparison of 5 Year Cumulative Total Return

Assumes Initial Investment of \$100

December 2011

Comparison of cumulative total return of one or more companies, peer groups, industry indexes and/or broad markets

**FISCAL YEAR ENDING**

| <b>Company/Index/Market</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Rand Capital Corporation    | \$ 100.00   | \$ 102.80   | \$ 100.00   | \$ 113.71   | \$ 92.29    | \$ 88.57    |
| NASDAQ Market Index         | \$ 100.00   | \$ 110.55   | \$ 66.30    | \$ 96.34    | \$ 113.70   | \$ 112.76   |
| Peer Group Index            | \$ 100.00   | \$ 71.80    | \$ 28.88    | \$ 51.32    | \$ 74.03    | \$ 71.31    |

The peer group is comprised of the following companies:

Ameritrans Capital Corp (NasdaqCM:AMTC)

Gladstone Investment Corporation (NasdaqGS:GAIN)

Harris & Harris Group, Inc. (NasdaqGM:TINY)

Hercules Technology Growth Capital, Inc. (NasdaqGS: HTGC)

Main Street Capital Corporation (NasdaqGS: MAIN)

MCG Capital Corporation (NasdaqGS:MCGC)

Triangle Capital Corporation (NasdaqGM: TCAP)

The Corporation selected the Peer Group on the basis of its belief that the seven issuers in the group are closed end investment companies that have elected to be regulated as BDCs and have investment objectives that are similar to those of the Corporation, and that among the publicly traded companies that have those attributes, they are relatively similar in size to the Corporation.

The performance graph information provided above will not be deemed to be soliciting material or filed with the SEC or subject to Regulations 14A or 14C, or to the liabilities of section 18 of the Securities Exchange Act,

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unless in the future the Corporation specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into any filing under the Securities Act or the Securities Exchange Act.

**Item 6. Selected Financial Data**

The following table provides selected consolidated financial data of the Corporation for the periods indicated. You should read the selected financial data set forth below in conjunction with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and with our consolidated financial statements and related notes appearing elsewhere in this report.

**Balance Sheet Data as of December 31:**

|                                       | 2011          | 2010          | 2009          | 2008          | 2007          |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Total assets                          | \$ 31,331,957 | \$ 35,091,260 | \$ 35,631,371 | \$ 32,228,797 | \$ 32,722,151 |
| Total liabilities                     | \$ 6,932,836  | \$ 12,040,442 | \$ 12,425,490 | \$ 12,001,831 | \$ 12,904,328 |
| Net assets                            | \$ 24,399,121 | \$ 23,050,818 | \$ 23,205,881 | \$ 20,226,966 | \$ 19,817,823 |
| Net asset value per outstanding share | \$ 3.58       | \$ 3.38       | \$ 3.40       | \$ 3.54       | \$ 3.47       |
| Common stock shares outstanding       | 6,818,934     | 6,818,934     | 6,818,934     | 5,718,934     | 5,718,934     |

**Operating Data for the year ended December 31:**

|   | 2011           | 2010           | 2009           | 2008         | 2007         |
|---|----------------|----------------|----------------|--------------|--------------|
| Investment income   | 1,292,352      | \$ 847,283     | \$ 1,749,525   | \$ 1,757,003 | \$ 2,302,870 |
| Total expenses  | 1,661,674      | \$ 2,367,911   | \$ 1,850,113   | \$ 1,721,555 | \$ 1,650,947 |
| Net investment (loss) gain  | \$ (81,738)    | \$ (973,189)   | \$ (63,878)    | \$ 135,689   | \$ 398,703   |
| Net realized (loss) gain on sales and dispositions of investments, net of tax | \$ (1,515,885) | \$ 3,222,688   | \$ 2,007,974   |              | \$ (42,045)  |
| Net increase (decrease) in unrealized appreciation, net of tax                | \$ 2,945,926   | \$ (2,404,562) | \$ (2,683,516) | \$ 273,454   | \$ 2,362,507 |
| Net increase (decrease) in net assets from operations                         | \$ 1,348,303   | \$ (155,063)   | \$ (739,420)   | \$ 409,143   | \$ 2,719,165 |

**Item 7. 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 financial statements and related notes included elsewhere in this report.

**FORWARD LOOKING STATEMENTS**

*Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report that do not relate to present or historical conditions are forward-looking statements within the meaning of that term in Section 27A of the Securities Act of 1933, and in Section 21F of the Securities Exchange Act of 1934. Additional oral or written forward-looking statements may be made by the Corporation from time to time, and forward-looking statements may be included in documents that are filed with the Securities and Exchange Commission. Forward-looking statements involve risks and uncertainties that could cause results or outcomes to differ materially from those expressed in the forward-looking statements. Forward-looking statements may include, without limitation, statements relating to the Corporation's plans, strategies, objectives, expectations and intentions and are intended to be made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words such as believes, forecasts, intends, possible, expects, estimates, anticipates, or plans and similar*

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*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 company trade or could be traded, liquidity within the national financial markets, and inflation. Forward-looking statements are also subject to the risks and uncertainties described under the caption Risk Factors contained in Part I, Item 1A of this report.*

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

## **Business Overview**

Rand Capital Corporation ( Rand ) was incorporated under the law of New York in 1969. Beginning in 1971, Rand operated as a publicly traded, closed-end, diversified management company that was registered under Section 8 of the Investment Company Act of 1940 (the 1940 Act ). In 2001, Rand elected to be treated as a business development company ( BDC ) under the 1940 Act. In 2002, Rand formed a wholly-owned subsidiary for the purpose of operating it as a small business investment company ( SBIC ) licensed by the U.S. Small Business Administration ( SBA ). The subsidiary received an SBA license to operate as an SBIC in August 2002. The subsidiary, which had been organized as a Delaware limited partnership, was converted into a New York corporation on December 31, 2008, at which time its operations as a licensed small business investment company were continued by a newly formed corporation under the name of Rand Capital SBIC, Inc. ( Rand SBIC ). On February 28, 2012 the SEC granted an Order of Exemption for Rand with respect to the operation of Rand SBIC. Although Rand SBIC is operated as if it were a BDC, it is currently registered as an investment company under the 1940 Act. Now that the Corporation has received the order granting the exemptions described above, Rand SBIC will promptly file an election to be regulated as a BDC under the 1940 Act. The following discussion describes the operations of Rand, its wholly-owned subsidiary Rand SBIC, and the predecessor wholly-owned limited partnership (collectively, the Corporation ).

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

The Corporation's primary business is making subordinated debt and equity investments in small and medium-sized companies that meet certain criteria, including:

- 1) a qualified and experienced management team
- 2) a new or unique product or service with a sustainable competitive advantage
- 3) high potential for growth in revenue and cash flow
- 4) potential to realize appreciation in an equity position, if any.

The Corporation typically makes investments that range from \$500,000 to \$1,000,000 directly to a company through equity shares or in debt or loan instruments. The debt instruments generally have a maturity of not more than five years and usually have detachable equity warrants. Interest is either paid currently or deferred.

The Corporation's management team identifies investment opportunities through a network of investment referral relationships. Investment proposals may, however, come to the Corporation from many other sources, including unsolicited proposals from the public and referrals from banks, lawyers, accountants and other members of the financial community. The Corporation believes that its reputation in the investment community and experience provide a competitive advantage in originating qualified new investments.

In a typical private financing, the management team of the Corporation will review, analyze, and confirm, through due diligence, the business plan and operations of the potential portfolio company. Additionally, the



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Corporation will become familiar with the portfolio company's industry and competitive landscape and may conduct reference checks with customers and suppliers of the portfolio company.

Following an initial investment in a portfolio company, the Corporation may make follow-on investments in the portfolio company. Follow-on investments may be made to take advantage of warrants or other preferential rights granted to the Corporation or to increase or maintain the Corporation's position in a promising portfolio company. The Corporation may also be called upon to provide an additional investment to a portfolio company in order for that company to fully implement its business plans, to develop a new line of business or to recover from unexpected business problems. Follow-on investments in a portfolio company are evaluated individually and may be subject to regulatory restrictions.

The Corporation may exit investments through the maturation of a debt security or when a liquidity event takes place, such as the sale, recapitalization, or initial public offering of a portfolio company. The method and timing of the disposition of the Corporation's portfolio investments can be critical to the realization of maximum total return. The Corporation generally expects to dispose of its equity securities through private sales of securities to other investors or through an outright sale of the company or a merger. The Corporation anticipates its debt investments will be repaid with interest and hopes to realize further appreciation from the warrants or other equity type instruments it receives in connection with the origination of the investment. The Corporation anticipates generating cash for new investments and operating expenses through existing cash balances, investment returns and interest and principal payments from its portfolio companies.

## **2011 Highlights and Outlook**

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

The Corporation's net asset value increased \$0.20, or 5.9% during 2011, closing the year at \$3.58 per share. At December 31, 2011, the Corporation's total investment portfolio was valued at \$23.9 million, which exceeds its cost basis of \$13.4 million, reflecting \$10.5 million in net unrealized appreciation.

The Corporation's common stock traded in a range that was above and below its net asset value per share during 2011 and 2010. The year closed with the stock trading at \$3.10, a discount to the net asset value of \$3.58.

During 2011 the Corporation recognized \$1,292,352 in total investment income, an increase of \$445,069 from \$847,283 of investment income in 2010. The 53% increase is attributable to a large increase in dividend income from \$120,071 in 2010 to \$516,189 during 2011. The Corporation received dividends from portfolio companies that are limited liability companies, which as a group comprise approximately 73% of the value of the Corporation's portfolio at December 31, 2011. Dividends from these portfolio companies may fluctuate from period to period based not only on the profitability of the portfolio company but also on the timing of distributions the companies make.

The Corporation had several significant portfolio valuation changes that resulted in a net increase in unrealized appreciation of \$2,945,926. Total expenses were \$1,661,674 for the year ended December 31, 2011 and this represents a \$(706,237) or 30% decrease from the 2010 expense amount of \$2,367,911 for the year ended December 31, 2010.

## **Critical Accounting Policies**

The Corporation prepares its financial statements in accordance with United States generally accepted accounting principles (GAAP), which requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities. For a summary of all significant accounting policies, including critical accounting policies, see Note 1 to the consolidated financial statements in Item 8 of this report.

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The increasing complexity of the business environment and applicable authoritative accounting guidance require the Corporation to closely monitor its accounting policies and procedures. The Corporation has two critical accounting policies that require significant judgment. The following summary of critical accounting policies is intended to enhance your ability to assess the Corporation's financial condition and results of operations and the potential volatility due to changes in estimates.

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

The most important estimate inherent in the preparation of the Corporation's consolidated financial statements is the valuation of its investments and the resulting unrealized appreciation or depreciation.

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

In September 2006, the Financial Accounting Standards Board (FASB) issued guidance on Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This statement was effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. On January 1, 2008, the Corporation adopted Accounting Standards Codification (ASC) 820.

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

Loan and debt securities are valued at cost when it is representative of the fair value of an investment or sufficient assets or liquidation proceeds exists from a sale of a portfolio company at its estimated fair value.

The loan and debt securities may be valued at an amount other than a similar level yielding market securities. A loan or debt instrument may be reduced in value if it is judged to be of poor quality, collection is in doubt or insufficient liquidation proceeds exist.

Equity securities may be valued using the market approach or income approach. The market approach uses observable prices and other relevant information generated by similar market transactions. It may include the use of market multiples derived from a set of comparables to assist in pricing the investment. Additionally, the Corporation adjusts valuations if a subsequent significant equity financing has occurred that includes a meaningful portion of the financing by a sophisticated, unrelated new investor. The income approach employs a cash flow and discounting methodology to value an investment.

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

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

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

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

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All of the Corporation's investments at December 31, 2011 are classified in Level 3 due to their privately held restricted nature.

In the valuation process, the Corporation uses financial information received monthly, quarterly, and annually from its portfolio companies, which includes both audited and unaudited financial statements, annual projections and budgets prepared by the portfolio company and other financial and non-financial business information supplied by the portfolio companies' management. This information is used to determine financial condition, performance, and valuation of the portfolio investments. The valuation may be reduced if a company's performance and potential have significantly deteriorated. If the factors which led to the reduction in valuation are overcome, the valuation may be restored.

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

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

**Revenue Recognition (Interest Income)**

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

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

The Corporation may receive distributions from portfolio companies that are limited liability companies. These distributions are classified as dividend income on the statement of operations and are recognized when the amount can be reasonably estimated.

**Recent Accounting Pronouncements**

In May, 2011 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and IFRS. ASU 2011-04 is required to be applied prospectively in interim and annual periods beginning after December 15, 2011. Early application is not permitted. Management does not anticipate that the implementation of this standard will have a material impact on the process for measuring fair values or on the consolidated financial statements.

**Financial Condition****Overview:**

|                   | 12/31/11      | 12/31/10      | (Decrease)<br>Increase | % (Decrease)<br>Increase |
|-------------------|---------------|---------------|------------------------|--------------------------|
| Total assets      | \$ 31,331,957 | \$ 35,091,260 | (\$ 3,759,303)         | (10.7%)                  |
| Total liabilities | 6,932,836     | 12,040,442    | (5,107,606)            | (42.4%)                  |
| Net assets        | \$ 24,399,121 | \$ 23,050,818 | \$ 1,348,303           | 5.8%                     |

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Net asset value per share (NAV) was \$3.58 per share at December 31, 2011 versus \$3.38 per share at December 31, 2010.

The Corporation paid off \$6,000,000 in SBA outstanding leverage during the third quarter of 2011 and the outstanding SBA leverage at December 31, 2011 was \$4,000,000. These debentures bear a fixed interest rate and an annual fee, averaging 4.8%, payable semi-annually.

Cash and cash equivalents approximated 19% of net assets at December 31, 2011 compared to 51% at December 31, 2010.

The effect of investment income, realized losses and the change in unrealized appreciation on investments resulted in an increase of \$1,639,324 in the net deferred tax liability from \$1,044,315 at December 31, 2010 to \$2,683,639 at December 31, 2011.

**Composition of the Corporation's Investment Portfolio**

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

|                              | 12/31/11      | 12/31/10      | (Decrease)<br>Increase | % (Decrease)<br>Increase |
|------------------------------|---------------|---------------|------------------------|--------------------------|
| Investments, at cost         | \$ 13,408,682 | \$ 13,573,041 | (\$ 164,359)           | (1.2%)                   |
| Unrealized appreciation, net | 10,523,179    | 5,791,584     | 4,731,595              | 81.7%                    |
| Investments, at fair value   | \$ 23,931,861 | \$ 19,364,625 | \$ 4,567,236           | 23.6%                    |

The Corporation's total investments at fair value, as estimated by management and approved by the Board of Directors, approximated 98% of net assets at December 31, 2011 and 84% of net assets at December 31, 2010.

The changes in investments during the year ended December 31, 2011, at cost, are comprised of the following:

**New Investments**

|                                   |              |
|-----------------------------------|--------------|
| BinOptics Corporation (Binoptics) | \$ 1,190,569 |
| Liazon Corporation (Liazon)       | 819,999      |
| Chequed.com, Inc (Chequed)        | 250,000      |
| SOMS Technologies, LLC (SOMS)     | 101,945      |

**Total of new investments during the year ended December 31, 2011** \$ 2,362,513

**Other Changes to Investments:**

|   |           |
|---|-----------|
| Microcision LLC (Microcision) interest conversion | \$ 97,237 |
| Liazon note accretion                             | 37,000    |
| Chequed interest conversion                       | 33,222    |

**Total of other changes to investments during the year ended December 31, 2011** \$ 167,459

**Investment Repaid/Sold or Liquidated:**

|  |                |
|--|----------------|
| Niagara Dispensing Technologies, Inc. (Niagara Dispensing) | (\$ 1,814,328) |
| Liazon   | (500,000)      |
| Associates Interactive LLC (Associates)                    | (293,518)      |
| Gemcor II, LLC (Gemcor)                                    | (86,485)       |

**Total of investments repaid, sold or liquidated during the year ended December 31, 2011** (\$ 2,694,331)

|  |                     |
|--|---------------------|
| <b>Total change in investments, at cost, during the year ended December 31, 2011</b> | <b>(\$ 164,359)</b> |
|--|---------------------|

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The Corporation's top five portfolio companies represented 55% of total assets at December 31, 2011:

| Company                             | Industry                             | Fair Value at<br>December 31, 2011 | % of Total Assets<br>at<br>December 31,<br>2011 |
|-------------------------------------|--------------------------------------|------------------------------------|---|
| Gemcor                              | Manufacturing Aerospace<br>Machinery | \$ 7,327,110                       | 23%   |
| Synacor Inc. (Synacor)              | Software                             | \$ 5,700,000                       | 18%   |
| Microcision                         | Manufacturing Medical<br>Products    | \$ 1,679,517                       | 5%  |
| Carolina Skiff LLC (Carolina Skiff) | Manufacturing Boats                  | \$ 1,500,000                       | 5%  |
| BinOptics                           | Manufacturing semiconductor          | \$ 1,190,569                       | 4%  |

The Corporation's top five portfolio companies represented 42% of total assets at December 31, 2010:

| Company                             | Industry                             | Fair Value at<br>December 31, 2010 | % of Total Assets<br>at<br>December 31,<br>2010 |
|-------------------------------------|--------------------------------------|------------------------------------|---|
| Gemcor                              | Manufacturing Aerospace<br>Machinery | \$ 6,113,596                       | 17%   |
| Synacor                             | Software                             | \$ 4,168,001                       | 12%   |
| Microcision                         | Manufacturing Medical Products       | \$ 1,582,282                       | 5%  |
| Carolina Skiff                      | Manufacturing Boats                  | \$ 1,500,000                       | 4%  |
| Ultra-Scan Corporation (Ultra-Scan) | Electronics Hardware/Software        | \$ 1,203,000                       | 3%  |

Below is the geographic breakdown of the Corporation's investments at fair value as of December 31, 2011 and 2010:

| Geographic Region | % of Net Asset<br>Value<br>at<br>December 31,<br>2011 | % of Net Asset<br>Value<br>at<br>December 31,<br>2010 |
|-------------------|---|---|
| USA - East        | 94%   | 92%   |
| USA - South       | 6%  | 8%  |
|                   | 100%  | 100%  |

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As of December 31, 2011 and 2010, the Corporation's investment portfolio consisted of the following investments:

|  | Cost          | Percentage of<br>Total<br>Portfolio | Fair Value    | Percentage of<br>Total<br>Portfolio |
|--|---------------|-------------------------------------|---------------|-------------------------------------|
| <b>December 31, 2011:</b>              |               |                                     |               |                                     |
| Subordinated Debt and Promissory Notes | \$ 3,181,675  | 24%                                 | \$ 3,181,675  | 13%                                 |
| Convertible Debt                       |               |                                     |               |                                     |
| Equity and Membership Interests        | 10,227,007    | 76                                  | 20,750,186    | 87                                  |
| Equity Warrants                        |               |                                     |               |                                     |
| Total                                  | \$ 13,408,682 | 100%                                | \$ 23,931,861 | 100%                                |
| <b>December 31, 2010:</b>              |               |                                     |               |                                     |
| Subordinated Debt and Promissory Notes | \$ 3,792,655  | 28%                                 | \$ 3,345,326  | 17%                                 |
| Convertible Debt                       | 663,596       | 5                                   | 663,596       | 4                                   |
| Equity and Membership Interests        | 9,078,590     | 67                                  | 15,317,503    | 79                                  |
| Equity Warrants                        | 38,200        |                                     | 38,200        |                                     |
| Total                                  | \$ 13,573,041 | 100%                                | \$ 19,364,625 | 100%                                |

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

Investment income for the year ended December 31, 2011 increased to \$1,292,352 from \$847,283 for the year ended December 31, 2010. This 52.5% increase was almost entirely attributable to an increase in the dividend income distributed to the Corporation.

**Comparison of the years ended December 31, 2011 and 2010**

|                                      | December 31,<br>2011 | December 31,<br>2010 | Increase   | % Increase |
|--------------------------------------|----------------------|----------------------|------------|------------|
| Interest from portfolio companies    | \$ 728,118           | \$ 688,177           | \$ 39,941  | 5.8%       |
| Interest from other investments      | 30,364               | 23,574               | 6,790      | 28.8%      |
| Dividend and other investment income | 516,189              | 120,071              | 396,118    | 329.9%     |
| Other income                         | 17,681               | 15,461               | 2,220      | 14.4%      |
| Total investment income              | \$ 1,292,352         | \$ 847,283           | \$ 445,069 | 52.5%      |

**Interest from portfolio companies** The portfolio interest income increase during 2011 is due to the origination of new debenture instruments from Chequed.com and Liazon during late 2010 and 2011 and the accretion of \$37,000 of Original Issue Discount (OID) income on the Liazon investment. 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 cost to the warrant and reduces the debt





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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 debt instrument associated with this OID was paid in full during the second quarter of 2011 and therefore all of the remaining OID was recognized as income.

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

| Company                           | Interest Rate | Investment Cost | Year that Interest Accrual Ceased |
|-----------------------------------|---------------|-----------------|-----------------------------------|
| G-Tec Natural Gas Systems (G-Tec) | 8%            | \$ 400,000      | 2004                              |

**Interest from other investments** The increase in interest from other investments is primarily due to higher cash balances and higher interest yields throughout the first nine months of the current year. The cash balance at December 31, 2011 and 2010 was \$4,517,985 and \$11,698,653, respectively. The Corporation paid off \$6,000,000 in outstanding SBA leverage in early September 2011 therefore reducing the cash balance at December 31, 2011 and decreasing interest revenue in the fourth quarter of 2011.

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

Dividend income for the year ended December 31, 2011 consisted of a distribution from Gemcor II, LLC (Gemcor) for \$262,284, New Monarch Machine Tool, Inc. (Monarch) for \$185,011, Somerset Gas Transmission Company (Somerset) for \$63,160, Carolina Skiff LLC (Carolina Skiff) for \$4,317 and NDT Acquisition LLC (NDT) for \$1,417. The Corporation exited its debt investment in Monarch in 2008 and retains ownership in the company. Monarch started distributing its profits to its investors during 2011.

Dividend income for the year ended December 31, 2010 consisted of distributions from Gemcor for \$87,880 and Somerset for \$32,191.

**Other income** Other income consists of the revenue associated with the amortization of financing fees charged to the portfolio companies upon successful closing of Rand SBIC financings. 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. 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 companies' board meetings.

The income associated with the amortization of financing fees was \$5,650 and \$2,461 for the years ended December 31, 2011 and 2010, respectively. There is no balance in the deferred revenue account at December 31, 2011.

The income associated with board attendance fees was \$12,000 and \$13,000 for the years ended December 31, 2011 and 2010, respectively.

**Comparison of the years ended December 31, 2010 and 2009**

|                                      | December 31,<br>2010 | December 31,<br>2009 | Increase<br>(Decrease) | %<br>Increase<br>(Decrease) |
|--------------------------------------|----------------------|----------------------|------------------------|-----------------------------|
| Interest from portfolio companies    | \$ 688,177           | \$ 568,524           | \$ 119,653             | 21.0%                       |
| Interest from other investments      | 23,574               | 17,129               | 6,445                  | 37.6%                       |
| Dividend and other investment income | 120,071              | 1,133,102            | (1,013,031)            | (89.4%)                     |
| Other income                         | 15,461               | 30,770               | (15,309)               | (49.8%)                     |
| <b>Total investment income</b>       | <b>\$ 847,283</b>    | <b>\$ 1,749,525</b>  | <b>(\$ 902,242)</b>    | <b>(51.6%)</b>              |



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**Interest from portfolio companies** The portfolio interest income increase during 2010 was due to the origination of new debenture instruments from Carolina Skiff, Gemcor, and Microcision in late 2009 and 2010.

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

| Company            | Interest Rate | Investment Cost | Year that Interest Accrual Ceased |
|--------------------|---------------|-----------------|-----------------------------------|
| Associates         | 8%            | \$ 291,331      | 2009                              |
| G-Tec              | 8%            | \$ 400,000      | 2004                              |
| Niagara Dispensing | 14%           | \$ 547,328      | 2010                              |

**Interest from other investments** The increase in interest from other investments was primarily due to higher cash balances throughout 2010. The cash balance at December 31, 2010 and 2009 was \$11,698,653 and \$9,417,236, respectively. The higher cash balance at December 31, 2010 was due to the drawdown of SBA leverage in the first quarter of 2010 and the cash proceeds received from the exit of Innov-X Systems, Inc. (Innovex) and GridApp Systems, Inc. (GridApp) during 2010.

**Dividend and other investment income** Dividend income was comprised of distributions from limited liability companies (LLCs) in which the Corporation had invested. The Corporation's investment agreements with certain LLC companies require the entities to distribute funds to the Corporation for payment of income taxes on its allocated 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 year ended December 31, 2010 consisted of distributions from Gemcor for \$87,880 and Somerset for \$32,191. Dividend income for the year ended December 31, 2009 consisted of distributions from Gemcor for \$1,101,526 and Somerset for \$31,576.

**Other income** Other income consists of the revenue associated with the amortization of financing fees charged to the portfolio companies upon successful closing of Rand SBIC financings. 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. 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 companies' board meetings.

The income associated with the amortization of financing fees was \$2,461 and \$11,750 for the years ended December 31, 2010 and 2009, respectively. The annualized financing fee income based on the existing portfolio was expected to be approximately \$1,400 in 2011 and \$1,100 in 2012.

The income associated with board attendance fees was \$13,000 for the year ended December 31, 2010 and \$19,000 for year ended December 31, 2009.

**Operating Expenses****Comparison of the years ended December 31, 2011 and 2010**

|                | December 31, 2011 | December 31, 2010 | Decrease     | % Decrease |
|----------------|-------------------|-------------------|--------------|------------|
| Total expenses | \$ 1,661,674      | \$ 2,367,911      | \$ (706,237) | (29.8)%    |

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

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The decrease in operating expenses during the year ended December 31, 2011 is comprised primarily of a 52% or \$586,834 decrease in salary expense and a 38% or \$72,969 decrease in the related employee benefit expense. Salary expense decreased due to the fact that the Corporation accrued \$660,634 in bonus and profit sharing obligations during the year ended December 31, 2010 and \$63,130 in bonus expense for the year ended December 31, 2011. There was no profit sharing earned during the year ended December 31, 2011. In addition, SBA interest expense decreased 7% or \$39,077 during 2011 due to the fact that the Corporation paid down \$6,000,000 in debentures during the third quarter of 2011.

**Comparison of the years ended December 31, 2010 and 2009**

|                | December 31,<br>2010 | December 31,<br>2009 | Increase   | % Increase |
|----------------|----------------------|----------------------|------------|------------|
| Total expenses | \$ 2,367,911         | \$ 1,850,113         | \$ 517,798 | 28.0%      |

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

The increase in operating expenses during the year ended December 31, 2010 was comprised primarily of an 80% or \$497,069 increase in salary expense, a 51% or \$64,290 increase in employee benefits and a 16% or \$77,240 increase in interest expense. Salary expense increased due to the accrual of \$660,634 in bonus and profit sharing obligations for the year ended December 31, 2010 versus a \$177,000 bonus and profit sharing accrual for the same period in 2009. Due to the increase in the bonus and profit sharing obligations the employee benefit expense also increased. SBA interest expense increased due to the additional \$1,900,000 in debenture instruments originated in December 2009 and January 2010. These expense increases were partly offset by the 29% or \$65,553 decrease in professional fees and the 107% or \$93,072 decrease in bad debt expense. Professional fees were higher in 2009 because the Corporation incurred additional expense related to compliance with SEC rules regarding the Corporation's operating structure and completion of a private sale of 1,100,000 of its common shares.

For the year ended December 31, 2009 the Corporation recorded an additional allowance for uncollectible interest of \$87,089.

**Net Realized Gains and Losses on Investments****Comparison of the years ended December 31, 2011 and 2010**

|                      | December 31,<br>2011 | December 31,<br>2010 | Change         | % Decrease |
|----------------------|----------------------|----------------------|----------------|------------|
| Realized (loss) gain | (\$ 2,205,551)       | \$ 4,962,742         | (\$ 7,168,293) | (144.4%)   |

During the year ended December 31, 2011, the Corporation recognized a loss of (\$1,780,612) on Niagara Dispensing, a loss of (\$293,519) on Associates and a loss of (\$131,420) on Innov-X Systems, Inc. (Innovex).

The Corporation recognized a realized loss of (\$1,780,612) on its investment in Niagara Dispensing after the company was sold during the second quarter of 2011. As part of the sale proceeds, the Corporation obtained an equity membership in an acquisition corporation which is entitled to a multi-year royalty on future product sales. Associates ceased doing business in the first quarter of 2011. The Corporation exited the Innovex investment in 2010 and part of the proceeds were held in escrow. This realized loss is a result of an adjustment to the escrow receivable balance.

**Comparison of the years ended December 31, 2010 and 2009**

|               | December 31,<br>2010 | December 31,<br>2009 | Change       | % Increase |
|---------------|----------------------|----------------------|--------------|------------|
| Realized gain | \$ 4,962,742         | \$ 3,161,913         | \$ 1,800,829 | 57.0%      |

During the year ended December 31, 2010, the Corporation recognized realized gains of \$4,403,984 on Innovex and \$ 2,719,569 on GridApp. There were also realized losses of (\$721,918) on Wineisit, (\$642,974) on Golden Goal, (\$631,547) on APF, (\$68,000) on ADAM, (\$49,830) on Bioworks, and (\$46,542) on Photonic.



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The Corporation sold its investment in Innovex to Olympus NDT Corporation on July 1, 2010 and received approximately \$5.6 million in net proceeds for its debt and equity securities. The realized gain from the sale was \$4,403,984 and included \$886,330 that was held in escrow. The Corporation received \$54,910 of this escrow during 2010. The escrow balance was adjusted during 2011 and the remainder was received in January 2012.

The Corporation exited its investment in GridApp with the sale of the entity to BMC Software, Inc. in November 2010. The Corporation received approximately \$4.3 million in proceeds and recognized a realized gain on the sale of \$2,719,569. This gain included \$957,563 that was held in escrow and is expected to be received in 2012. Both the Innovex and GridApp escrow holdbacks are recorded in Other Assets on the Balance Sheet.

The Corporation recognized a realized loss of (\$721,918) on its investment in Wineisit after the company reorganized during the fourth quarter of 2010 into a new entity named Advantage 24/7 LLC (Advantage 24/7). As part of this reorganization the Corporation obtained a controlling interest in Advantage 24/7. The Corporation evaluated the new entity's business and determined that the investment had a fair value of \$100,000.

The Adam and Golden Goal investments were written off during 2010 after each of the businesses were sold and the Corporation recognized realized losses of (\$68,000) on Adam and (\$642,974) on Golden Goal. In addition, the Corporation sold its investment in Bioworks, Inc. and recognized a \$49,830 realized loss.

The Corporation recognized a realized loss on APF Group, Inc. (APF). APF filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code in September 2009.

The Corporation sold 30,500 shares of Photonic Products Group, Inc (Photonic) stock. Photonic is a publicly traded stock (NASDAQ symbol: PHPG.OB). The average sales price of Photonic was \$1.00/share and the cost basis of the stock was \$2.50/share.

**Change in Unrealized Appreciation of Investments**

*For the years ended December 31, 2011 and 2010*

|                                   | December 31,<br>2011 | December 31,<br>2010 | Change       |
|-----------------------------------|----------------------|----------------------|--------------|
| Change in Unrealized Appreciation | \$ 4,731,595         | (\$ 3,736,642)       | \$ 8,468,237 |

The increase in unrealized appreciation for the year ended December 31, 2011 was comprised of the following items:

| Portfolio Company  | Valuation<br>Change<br>during 2011 |
|--|------------------------------------|
| Reclass Niagara Dispensing to realized loss  | \$ 1,729,113                       |
| Synacor  | 1,531,999                          |
| Gemcor   | 1,300,000                          |
| Reclass Associates to a realized loss  | 293,518                            |
| Liazon   | 141,801                            |
| Ultra-Scan Corporation (Ultra-Scan)  | (264,836)                          |
| <b>Total change in net unrealized appreciation during the year ended December 31, 2011</b> | <b>\$ 4,731,595</b>                |

The Corporation increased its value in Synacor based on an analysis of the financial and operational growth of the portfolio company. Synacor, Inc. filed a Form S-1 registration statement on November 18, 2011 with the SEC and completed an Initial Public Offering (IPO) on February 10, 2012 trading on the NASDAQ National Market under the symbol SYNC.



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The Corporation recognized appreciation on its equity investment in Gemcor based on the improved financial condition of the portfolio company. Per the Corporation's valuation policy, a portfolio company can be valued based on a conservative financial measure if the portfolio company has been self-financing and has had positive cash flow from operations for at least the past two fiscal years.

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

**For the years ended December 31, 2010 and 2009**

|                                   | December 31,<br>2010 | December 31,<br>2009 | Change     |
|-----------------------------------|----------------------|----------------------|------------|
| Change in Unrealized Appreciation | (\$ 3,736,642)       | (\$ 4,211,605)       | \$ 474,963 |

The decrease in unrealized appreciation on investments of \$3,736,642 was due to the following valuation changes made by the Corporation:

| Portfolio Company  | Valuation<br>Change<br>during<br>2010 |
|--|---------------------------------------|
| Reclass Wineisit to a realized loss  | 721,918                               |
| Reclass Golden Goal to a realized loss   | 656,652                               |
| Reclass APF to a realized loss   | 631,547                               |
| Reclass GridApp to realized gain   | 295,935                               |
| Advantage 24/7   | 100,000                               |
| Reclass Bioworks, Inc. to a realized loss  | 56,000                                |
| SOMS appreciation  | 55,717                                |
| Reclass Photonics to a realized loss   | 45,752                                |
| Niagara Dispensing depreciation  | (1,250,163)                           |
| Reclass Innovex to realized gain   | (5,050,000)                           |
| <b>Total Change in Unrealized Appreciation during the year ended December 31, 2010</b> | <b>(\$ 3,736,642)</b>                 |

In accordance with its valuation policy, the Corporation increased the value of its holdings in SOMS based on a significant equity financing in June 2010 by a new, non-strategic outside investor.

The Corporation's investment in Niagara Dispensing was written down by \$1,250,163 during the year ended December 31, 2010 after a review by the Corporation of Niagara Dispensing's financials and an analysis of the liquidation preferences of senior securities.

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

**Net Increase (Decrease) 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 (decrease) in net assets from operations on its consolidated statements of operations. During the year ended December 31, 2011, the net increase in net assets from operations was \$1,348,303 as compared to a net decrease of (\$155,063) in 2010 and a net decrease of (\$739,420) in 2009.

The net increase in net assets from operations for the year ended December 31, 2011 was due to the net unrealized appreciation on investments of \$2,945,926 which was offset by the net investment loss of (\$81,738) and the net realized loss of (\$1,515,885). The net decrease in net assets from operations for the year ended December 31, 2010 can be attributed to the net investment loss of (\$973,189) which was offset by the net realized and unrealized gain on investments of \$818,126. The net decrease in net assets from operations for the year ended December 31, 2009 is due to the net investment loss of (\$63,878) coupled with the net decrease in realized and unrealized loss on investments of (\$675,542).





**Table of Contents****Liquidity and Capital Resources**

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

As of December 31, 2011, the Corporation's total liquidity, consisting of cash and cash equivalents, was \$4,517,985.

Net cash used in operating activities has averaged approximately \$1,039,000 over the last three years and management anticipates cash will continue to be utilized at similar levels. The cash flow may fluctuate based on realized gains and the associated income taxes paid.

The Corporation used approximately \$1,742,000 in net cash flow from investing activities for the fiscal year 2011 and provided approximately \$4,700,000 in net cash flow from investing activities in fiscal 2010 and approximately \$2,400,000 during fiscal year 2009. The Corporation will generally use cash in investing activities as it builds its portfolio utilizing its available cash and proceeds from liquidations of portfolio investments. The Corporation anticipates that it will continue to exit investments over the next several years. However, significant liquidating events within the Corporation's investment portfolio are difficult to project with any certainty.

To reserve the approved SBA debenture leverage the Corporation must pay an upfront 1% commitment fee to the SBA as a partial prepayment of the SBA's nonrefundable 3% leverage fee. These fees are then expensed over the life of the corresponding debenture instruments. The Corporation paid \$100,000 to reserve the original \$10,000,000 in SBA leverage. When this original SBA commitment expired in December 2008, Rand SBIC re-applied for the remaining \$1,900,000 in leverage and paid the SBA an additional commitment fee of \$19,000 to reserve this leverage. During 2011, the Corporation repaid \$6,000,000 in existing SBA leverage and contributed \$1,000,000 of regulatory capital into the Rand SBIC, Inc. subsidiary. Additionally, during 2011 the SBA approved \$8,000,000 in new SBA leverage and the Corporation paid the \$80,000 commitment fee to reserve this leverage. The total outstanding leverage was \$4,000,000 at December 31, 2011 and the total remaining SBA commitment at December 31, 2011 is \$8,000,000.

The Corporation has liquidity consisting of cash and cash equivalents and the remaining SBA commitment of \$8,000,000 that may be utilized to fund new investments in 2012.

The following table summarizes the cash to be received over the next five years from portfolio companies based on contractual obligations as of December 31, 2011. This table does not include any escrow receivable amounts. These payments represent scheduled principal and interest payments that are contained in the investment documents of each portfolio company.

**Cash Receipts due by year**

|  | <b>2012</b> | <b>2013</b>  | <b>2014</b> | <b>2015</b> | <b>2016 and<br/>beyond</b> |
|--|-------------|--------------|-------------|-------------|----------------------------|
| Scheduled Cash Receipts from Portfolio Companies | \$ 290,000  | \$ 2,900,000 | \$ 40,000   | \$ 45,000   | \$ 760,000                 |

The preceding table only includes debenture instruments and does not include any equity investments which may provide additional proceeds upon exit of these securities.

The global economy experienced a great deal of turmoil throughout the last several years and this affected the debt and equity markets in the United States. The markets have been improving but the effects of this economic crisis linger and the economy has yet to fully recover. This unfavorable change in credit market conditions has created opportunities for capital providers, like the Corporation, because small businesses are selling for lower prices, and they are generally willing to pay higher interest rates and to accept contractual terms that are more favorable to the Corporation. Accordingly, for companies that continue to have access to capital, management believes that the current environment could provide investment opportunities on more favorable terms than have been available in recent prior periods.

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Management expects that the cash and cash equivalents at December 31, 2011, coupled with the available SBA leverage and the scheduled interest and dividend payments on its portfolio investments, will be sufficient to meet the Corporation's cash needs throughout 2012. The Corporation is also evaluating potential exits from portfolio companies to increase the amount of liquidity available for new investments, operating activities and future SBA debenture obligations.

**Contractual Obligations**

The following table shows the Corporation's specified contractual obligations at December 31, 2011. The Corporation does not have any capital lease obligations or other long-term liabilities reflected on its balance sheet.

|  | Payments due by period |                     |                   |                     |                     |
|--|------------------------|---------------------|-------------------|---------------------|---------------------|
|  | Total                  | Less than<br>1 year | 1-3<br>years      | 3-5<br>years        | More<br>than 5 yrs  |
| SBA Debentures                                     | \$ 4,000,000           | \$ 0                | \$ 0              | \$ 2,100,000        | \$ 1,900,000        |
| SBA Interest Expense                               | \$ 1,277,101           | \$ 211,363          | \$ 421,570        | \$ 352,148          | \$ 292,020          |
| Operating Lease Obligations (Rent of office space) | \$ 70,800              | \$ 17,160           | \$ 35,400         | \$ 18,240           | \$ 0                |
| <b>Total</b>                                       | <b>\$ 5,347,901</b>    | <b>\$ 228,523</b>   | <b>\$ 456,970</b> | <b>\$ 2,470,388</b> | <b>\$ 2,192,020</b> |

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

The Corporation's investment activities contain elements of risk. The portion of the Corporation's investment portfolio consisting of equity and debt securities in private companies is subject to valuation risk. Because there is typically no public market for the equity and debt securities in which it invests, the valuation of the equity interests in the portfolio is stated at fair value as determined in good faith by the management of the Corporation and submitted to the Board of Directors for approval. This is in accordance with the Corporation's investment valuation policy. (The discussion of valuation policy contained in Note 1- Summary of Significant Accounting Policies Investments in the consolidated financial statements contained in Item 8 of this report is hereby incorporated herein by reference.) In the absence of readily ascertainable market values, the estimated value of the Corporation's portfolio may differ significantly from the values that would be placed on the portfolio if a ready market for the investments existed. Any changes in valuation are recorded in the Corporation's consolidated statement of operations as Net unrealized appreciation (depreciation) on investments.

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 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 December 31, 2011, the Corporation did not have any off-balance sheet arrangements or hedging or similar derivative financial instrument investments.

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**Item 8. *Financial Statements and Supplementary Data***

The following consolidated financial statements and consolidated supplemental schedule of the Corporation and report of Independent Registered Public Accounting Firm thereon are set forth below:

|  |    |
|--|----|
| <u>Statements of Financial Position as of December 31, 2011 and 2010</u>   | 26 |
| <u>Statements of Operations for the three years in the period ended December 31, 2011</u>  | 27 |
| <u>Statements of Changes in Net Assets for the three years in the period ended December 31, 2011</u>                               | 28 |
| <u>Statements of Cash Flows for the three years in the period ended December 31, 2011</u>  | 29 |
| <u>Schedule of Portfolio Investments as of December 31, 2011</u>   | 30 |
| <u>Schedules of Selected Per Share Data and Ratios for the five years in the period ended December 31, 2011</u>                    | 33 |
| <u>Notes to the Consolidated Financial Statements</u>  | 34 |
| <u>Supplemental Schedule of Consolidated Changes in Investments at Cost and Realized Loss for the year ended December 31, 2011</u> | 47 |
| <u>Report of Independent Registered Public Accounting Firm</u>   | 48 |

**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION****December 31,**

|  | 2011                 | 2010                 |
|--|----------------------|----------------------|
| <b>ASSETS</b>  |                      |                      |
| Investments at fair value:   |                      |                      |
| Control investments (cost of \$966,895 and \$1,413,596, respectively)  | \$ 7,466,896         | \$ 6,313,596         |
| Affiliate investments (cost of \$6,083,260 and \$8,036,650, respectively)                                    | 5,838,975            | 6,334,571            |
| Non-affiliate investments (cost of \$6,358,527 and \$4,122,795, respectively)                                | 10,625,990           | 6,716,458            |
| Total investments, at fair value (cost of \$13,408,682 and \$13,573,041, respectively)                       | 23,931,861           | 19,364,625           |
| Cash and cash equivalents  | 4,517,985            | 11,698,653           |
| Interest receivable (net of allowance: 2011 \$122,000 and 2010 \$158,245)                                    | 83,869               | 1,051,848            |
| Prepaid income taxes   | 822,789              | 414,745              |
| Other assets   | 1,975,453            | 2,561,389            |
| <b>Total assets</b>  | <b>\$ 31,331,957</b> | <b>\$ 35,091,260</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (NET ASSETS)</b>   |                      |                      |
| <b>Liabilities:</b>  |                      |                      |
| Debentures guaranteed by the SBA   | \$ 4,000,000         | \$ 10,000,000        |
| Deferred tax liability   | 2,683,639            | 1,044,315            |
| Accounts payable and accrued expenses  | 249,197              | 990,477              |
| Deferred revenue   |                      | 5,650                |
| Total liabilities  | 6,932,836            | 12,040,442           |
| <b>Stockholders' equity (net assets):</b>  |                      |                      |
| Common stock, \$.10 par; shares authorized 10,000,000; shares issued 6,863,034; shares outstanding 6,818,934 | 686,304              | 686,304              |
| Capital in excess of par value   | 10,581,789           | 10,581,789           |
| Accumulated net investment (loss)  | (1,729,856)          | (1,648,118)          |
| Undistributed net realized gain on investments   | 8,317,397            | 9,833,282            |
| Net unrealized appreciation on investments   | 6,590,693            | 3,644,767            |
| Treasury stock, at cost, 44,100 shares   | (47,206)             | (47,206)             |
| Total stockholders' equity (net assets), (per share 2011 \$3.58, 2010 \$3.38)                                | 24,399,121           | 23,050,818           |
| <b>Total liabilities and stockholders' equity (net assets)</b>   | <b>\$ 31,331,957</b> | <b>\$ 35,091,260</b> |

See accompanying notes

**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****For The Years Ended December 31, 2011, 2010 and 2009**

|   | 2011             | 2010               | 2009             |
|---|------------------|--------------------|------------------|
| <b>Investment income:</b>                       |                  |                    |                  |
| Interest from portfolio companies:              |                  |                    |                  |
| Control investments                             | \$ 55,173        | \$ 67,952          | \$ 11,620        |
| Affiliate investments                           | 625,389          | 603,557            | 540,679          |
| Non-Control/Non-Affiliate investments           | 47,556           | 16,668             | 16,225           |
| Total interest from portfolio companies         | 728,118          | 688,177            | 568,524          |
| Interest from other investments:                |                  |                    |                  |
| Non-Control/Non-Affiliate investments           | 30,364           | 23,574             | 17,129           |
| Total Interest from other investments           | 30,364           | 23,574             | 17,129           |
| Dividend and other investment income:           |                  |                    |                  |
| Control investments                             | 263,701          | 87,880             | 1,101,526        |
| Affiliate investments                           | 189,328          |                    |                  |
| Non-Control/Non-Affiliate investments           | 63,160           | 32,191             | 31,576           |
| Total Dividend and other investment income      | 516,189          | 120,071            | 1,133,102        |
| Other income:                                   |                  |                    |                  |
| Control investments                             | 8,333            | 9,000              | 10,417           |
| Affiliate investments                           | 4,000            | 6,378              | 20,333           |
| Non-Control/Non-Affiliate investments           | 5,348            | 83                 | 20               |
| Total other income                              | 17,681           | 15,461             | 30,770           |
| <b>Total investment income</b>                  | <b>1,292,352</b> | <b>847,283</b>     | <b>1,749,525</b> |
| <b>Operating expenses:</b>                      |                  |                    |                  |
| Salaries  | 475,000          | 460,200            | 446,765          |
| Bonus and profit sharing                        | 59,000           | 660,634            | 177,000          |
| Employee benefits                               | 117,367          | 190,336            | 126,046          |
| Directors fees                                  | 80,250           | 88,500             | 76,750           |
| Professional fees                               | 145,132          | 161,862            | 227,415          |
| Stockholders and office operating               | 120,612          | 122,029            | 140,554          |
| Insurance                                       | 35,281           | 39,133             | 49,988           |
| Corporate development                           | 69,005           | 60,849             | 55,749           |
| Other operating                                 | 24,389           | 15,636             | (34,718)         |
|   | <b>1,126,036</b> | <b>1,799,179</b>   | <b>1,265,549</b> |
| Interest on SBA obligations                     | 535,638          | 574,715            | 497,475          |
| Bad debt (recovery) expense                     |                  | (5,983)            | 87,089           |
| Total expenses                                  | <b>1,661,674</b> | <b>2,367,911</b>   | <b>1,850,113</b> |
| <b>Investment loss before income taxes</b>      | <b>(369,322)</b> | <b>(1,520,628)</b> | <b>(100,588)</b> |
| Income tax benefit                              | (287,584)        | (547,439)          | (36,710)         |
| <b>Net investment loss</b>                      | <b>(81,738)</b>  | <b>(973,189)</b>   | <b>(63,878)</b>  |
| <b>Net realized (loss) gain on investments:</b> |                  |                    |                  |

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|  |                     |                     |                     |
|--|---------------------|---------------------|---------------------|
| Affiliate investments  | (2,205,551)         | 5,127,114           | (550,030)           |
| Non-Control/Non-Affiliate investments  |                     | (164,372)           | 3,711,943           |
| Realized (loss) gain on sales and dispositions, net                                      | (2,205,551)         | 4,962,742           | 3,161,913           |
| Income tax (benefit) expense   | (689,666)           | 1,740,054           | 1,153,939           |
| Net realized (loss) gain on investments  | (1,515,885)         | 3,222,688           | 2,007,974           |
| <b>Net increase (decrease) in unrealized appreciation on investments:</b>                |                     |                     |                     |
| Control investments  | 1,300,000           |                     | (98,000)            |
| Affiliate investments  | 2,022,631           | (3,838,394)         | (3,697,555)         |
| Non-Control/Non-Affiliate investments  | 1,408,964           | 101,752             | (416,050)           |
| Change in unrealized appreciation before income taxes                                    | 4,731,595           | (3,736,642)         | (4,211,605)         |
| Deferred income tax expense (benefit)  | 1,785,669           | (1,332,080)         | (1,528,089)         |
| Net increase (decrease) in unrealized appreciation                                       | 2,945,926           | (2,404,562)         | (2,683,516)         |
| <b>Net realized and unrealized gain (loss) on investments</b>                            | <b>1,403,041</b>    | <b>818,126</b>      | <b>(675,542)</b>    |
| <b>Net increase (decrease) in net assets from operations</b>                             | <b>\$ 1,348,303</b> | <b>\$ (155,063)</b> | <b>\$ (739,420)</b> |
| <b>Weighted average shares outstanding</b>   | <b>6,818,934</b>    | <b>6,818,934</b>    | <b>6,115,081</b>    |
| <b>Basic and diluted net (decrease) increase in net assets from operations per share</b> | <b>\$ 0.20</b>      | <b>\$ (0.02)</b>    | <b>\$ (0.12)</b>    |

See accompanying notes

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**RAND CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**

**For The Years Ended December 31, 2011, 2010 and 2009**

|   | <b>2011</b>          | <b>2010</b>   | <b>2009</b>   |
|---|----------------------|---------------|---------------|
| <b>Net assets at beginning of period</b>                          | <b>\$ 23,050,818</b> | \$ 23,205,881 | \$ 20,226,966 |
| Net investment loss   | <b>(81,738)</b>      | (973,189)     | (63,878)      |
| Net realized (loss) gain on sales and dispositions of investments | <b>(1,515,885)</b>   | 3,222,688     | 2,007,974     |
| Net increase (decrease) in unrealized appreciation                | <b>2,945,926</b>     | (2,404,562)   | (2,683,516)   |
| <b>Net increase (decrease) in net assets from operations</b>      | <b>1,348,303</b>     | (155,063)     | (739,420)     |
| Issuance of common stock  |                      |               | 3,718,335     |
| <b>Total increase (decrease)</b>                                  | <b>1,348,303</b>     | (155,063)     | 2,978,915     |
| <b>Net assets at end of period</b>                                | <b>\$ 24,399,121</b> | \$ 23,050,818 | \$ 23,205,881 |

See accompanying notes.



**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS****For The Years Ended December 31, 2011, 2010 and 2009**

|  | 2011               | 2010               | 2009             |
|--|--------------------|--------------------|------------------|
| <b>Cash flows from operating activities:</b>   |                    |                    |                  |
| Net increase (decrease) in net assets from operations  | \$ 1,348,303       | (\$ 155,063)       | (\$ 739,420)     |
| Adjustments to reconcile net increase (decrease) in net assets to net cash used in operating activities: |                    |                    |                  |
| Depreciation and amortization  | 98,193             | 39,521             | 36,218           |
| Original issue discount accretion  | (37,000)           |                    |                  |
| Change in interest receivable allowance  | (36,245)           | (50,844)           | 86,272           |
| (Increase) decrease in unrealized appreciation of investments  | (4,731,595)        | 3,736,642          | 4,211,605        |
| Deferred tax (benefit) expense   | 1,639,324          | (764,685)          | (1,681,000)      |
| Realized loss (gain) on portfolio investments, net   | 2,205,551          | (4,962,742)        | (3,161,913)      |
| Payment in kind, interest accrued  |                    |                    | (115,334)        |
| Non-cash conversion of debenture interest  | (130,459)          | (366,282)          | (41,599)         |
| Changes in operating assets and liabilities:   |                    |                    |                  |
| Decrease (increase) in interest receivable   | 1,004,224          | 191,114            | (264,502)        |
| Decrease (increase) in other assets  | 436,323            | (63,384)           | 137,059          |
| (Increase) in prepaid income taxes   | (408,044)          | (414,745)          |                  |
| (Decrease) increase in income taxes payable  |                    | (1,082,646)        | 983,923          |
| (Decrease) increase in accounts payable and accrued liabilities  | (741,280)          | 559,244            | 138,502          |
| (Decrease) increase in deferred revenue  | (5,650)            | 3,039              | (17,766)         |
| Total adjustments  | (706,658)          | (3,175,768)        | 311,465          |
| <b>Net cash provided by (used in) operating activities</b>   | <b>641,645</b>     | <b>(3,330,831)</b> | <b>(427,955)</b> |
| <b>Cash flows from investing activities:</b>   |                    |                    |                  |
| Investments originated   | (2,362,513)        | (3,606,200)        | (2,955,309)      |
| Proceeds from sale of portfolio investments  |                    | 8,230,833          | 4,946,781        |
| Proceeds from loan repayments  | 620,200            | 110,286            | 420,981          |
| Capital expenditures   |                    | (846)              |                  |
| <b>Net cash (used in) provided by investing activities</b>   | <b>(1,742,313)</b> | <b>4,734,073</b>   | <b>2,412,453</b> |
| <b>Cash flows from financing activities:</b>   |                    |                    |                  |
| Issuance of common stock, net  |                    |                    | 3,718,335        |
| Repayment of SBA debentures  | (6,000,000)        |                    |                  |
| Proceeds from SBA debentures   |                    | 900,000            | 1,000,000        |
| Origination costs to SBA   | (80,000)           | (21,825)           | (43,250)         |
| <b>Net cash (used in) provided by financing activities</b>   | <b>(6,080,000)</b> | <b>878,175</b>     | <b>4,675,085</b> |
| <b>Net (decrease) increase in cash and cash equivalents</b>  | <b>(7,180,668)</b> | <b>2,281,417</b>   | <b>6,659,583</b> |
| <b>Cash and cash equivalents:</b>  |                    |                    |                  |
| Beginning of year  | 11,698,653         | 9,417,236          | 2,757,653        |
| End of year  | \$ 4,517,985       | \$ 11,698,653      | \$ 9,417,236     |

See accompanying notes



**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****CONDENSED CONSOLIDATED SCHEDULE OF PORTFOLIO INVESTMENTS****December 31, 2011**

| (a)   |  | (b)           | (c)    | (d)(f)       | Per                 |
|---|--|---------------|--------|--------------|---------------------|
| Company, Geographic Location, Business Description, (Industry)  | Type of Investment   | Date Acquired | Equity | Cost         | Share of Rand       |
| and Website   |  |               |        | Value        |                     |
| <b>Non-Control/Non-Affiliate Investments:(j)</b>  |  |               |        |              |                     |
| <b>BinOptics Corporation(e)(g)</b>  | 13,818,122 Series 2 preferred shares.  | 11/8/11       | 4%     | \$ 1,190,569 | \$ 1,190,569 \$ .17 |
| Ithaca, NY. Design and manufacture of semiconductor FP and DFB lasers. (Electronics Developer)  |  |               |        |              |                     |
| www.binoptics.com   |  |               |        |              |                     |
| <b>Liazon Corporation(g)</b>  | 120,000 Series C-1 preferred shares. 546,667 Series C-2 preferred shares.        | 11/9/10       | 4%     | 858,199      | 1,000,000 .15       |
| Buffalo, NY. Employee benefits solution company. (Health Benefits Provider)   |  |               |        |              |                     |
| www.liazon.com  |  |               |        |              |                     |
| <b>Mezmeriz, Inc.(e)(g)</b>   | 141,125 Series A preferred shares.   | 1/9/08        | 4%     | 121,509      | 121,509 .02         |
| Ithaca, NY. Developer of micro mirror technology that replaces silicon with carbon fibers in micro-electronic mechanical systems (MEMS) enabling efficient, wide-angle, Pico projectors to be embedded in mobile devices. (Electronics Developer) |  |               |        |              |                     |
| www.mezmeriz.com  |  |               |        |              |                     |
| <b>Rheonix, Inc.(e)</b>   | 9,676 common shares.(g) 694,015 Series A preferred shares. 50,593 common shares. | 10/29/09      | 4%     | 753,000      | 889,000 .13         |

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|  |  |  |          |    |              |               |         |
|--|--|--|----------|----|--------------|---------------|---------|
| Ithaca, NY. Developer of microfluidic testing devices including channels, pumps, reaction vessels, & diagnostic chambers, for testing of small volumes of chemicals and biological fluids.<br>(Manufacturing)<br>www.rheonix.com | <b>Somerset Gas Transmission Company, LLC</b>  | 26.5337 units.   | 7/10/02  | 3% | 719,097      | 786,748       | .12     |
| Columbus, OH. Natural gas transportation company. (Oil and Gas)<br><br>www.somersetgas.com   | <b>Synacor Inc.(e)(g)</b>                      | 234,558 Series A preferred shares. 600,000 Series B preferred shares. 240,378 Series C preferred shares. 897,438 common shares.  | 11/18/02 | 4% | 1,349,479    | 5,700,000     | .84     |
| Buffalo, NY. Develops provisioning platforms for aggregation and delivery of content and services across multiple digital devices. (Software)<br><br>www.synacor.com   | <b>Ultra Scan Corporation (e)</b>              | 536,596 common shares. 107,104 Series A-1 preferred shares.  | 12/11/92 | 2% | 938,164      | 938,164       | .14     |
| Amherst, NY. Biometrics application developer of ultrasonic fingerprint technology. (Electronics Hardware/Software)<br><br>www.ultra-scan.com  | <b>(g) 95,284 Series A-1 preferred shares.</b> |  |          |    |              |               |         |
| <b>Subtotal Non-Control/Non-Affiliate Investments</b>  |  |  |          |    | \$ 5,930,017 | \$ 10,625,990 | \$ 1.57 |
| <b>Affiliate Investments:(k)</b>   |  |  |          |    |              |               |         |
| Waycross, GA. Manufacturer of fresh water, ocean fishing and pleasure boats.<br>(Manufacturing)<br>www.carolinaskiff.com   | <b>Chequed.com, Inc.(e)(g)</b>                 | \$985,000 Class A preferred membership interest at 14%. Redeemable December 23, 2012. \$500,000 subordinated promissory note at 14% due December 31, 2016. 6.0825% class A common membership interest. | 1/30/04  | 7% | \$ 1,500,000 | \$ 1,500,000  | \$ .22  |
|  | <b>Chequed.com, Inc.(e)(g)</b>                 | 157,464 Series A preferred shares.   | 11/18/10 | 8% | 533,222      | 533,222       | .08     |
| Saratoga Springs, NY. Predictive employee selection and development  |  |  |          |    |              |               |         |

software. (Software)

[www.chequed.com](http://www.chequed.com)

**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****CONSOLIDATED SCHEDULE OF PORTFOLIO INVESTMENTS****December 31, 2011 (Continued)**

| (a)  |   | (b)              | (c)    |           | (d)(f)    | Per<br>Share<br>of<br>Rand |
|--|---|------------------|--------|-----------|-----------|----------------------------|
| Company, Geographic Location, Business<br>Description, (Industry) and Website  | Type of Investment  | Date<br>Acquired | Equity | Cost      | Value     |                            |
| <b>EmergingMed.com, Inc.(g)</b><br>New York, NY. Cancer clinical<br>trial matching and referral service.<br>(Software)<br>www.emergingmed.com  | \$675,046 senior subordinated note at 8%<br>due January 19, 2013. Warrants for 8% of<br>common stock.<br><br>(i) Interest receivable \$51,004 | 12/19/05         | 8%     | 675,046   | 675,046   | .10                        |
| <b>G-TEC Natural Gas Systems(e)</b><br>Buffalo, NY. Manufactures and<br>distributes systems that allow<br>natural gas to be used as an<br>alternative fuel to gases.<br>(Manufacturing)<br>www.gas-tec.com         | 21.6% Class A membership interest. 8%<br>cumulative dividend.   | 8/31/99          | 22%    | 400,000   | 100,000   | .01                        |
| <b>Microcision LLC(g)</b><br>Philadelphia, PA. Custom<br>manufacturer of medical and dental<br>implants. (Manufacturing).<br>www.microcision.com   | \$1,500,000 subordinated promissory note<br>at 5%, 6% deferred interest due December<br>31, 2013. 15% class A common<br>membership interest.  | 9/24/09          | 15%    | 1,679,518 | 1,679,518 | .25                        |
| <b>Mid America Brick &amp; Structural Clay Products,<br/>LLC(e)(g)</b><br>Mexico, MO. Manufacturer of face<br>brick for residential and<br>commercial construction.<br>(Manufacturing).<br>www.midamericabrick.com | 19.524 membership units.  | 6/1/10           | 19%    | 800,000   | 800,000   | .12                        |

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|   |   |          |     |               |               |         |
|---|---|----------|-----|---------------|---------------|---------|
| <b>SOMS Technologies, LLC(e)(g)</b>   | 5,959,490 Series B membership units.  | 12/2/08  | 10% | 472,632       | 528,348       | .08     |
| Valhalla, NY. Produces and markets the microGreen Extended Performance Oil Filter. (Auto Parts Developer)<br>www.microgreenfilter.com         |   |          |     |               |               |         |
| <b>Subtotal Affiliate Investments</b>   |   |          |     | \$ 6,060,418  | \$ 5,816,134  | \$ .86  |
| <b>Control Investments(l)</b>   |   |          |     |               |               |         |
| <b>Advantage 24/7 LLC(e)(g)</b>   | 50% Membership interest.  | 12/30/10 | 50% | \$ 100,000    | \$ 100,000    | \$ .01  |
| Williamsville, NY. Marketing program for wine and spirits dealers. (Marketing Company)  |   |          |     |               |               |         |
| <b>Gemcor II, LLC(g)(h)</b>   | \$500,000 subordinated promissory note at 15% due December 1, 2014. 25 membership units. Warrant to purchase 6.25 membership units. | 6/28/04  | 31% | 827,111       | 7,327,111     | 1.07    |
| West Seneca, NY. Designs and sells automatic riveting machines used in the assembly of aircraft components. (Manufacturing)<br>www.gemcor.com |   |          |     |               |               |         |
| <b>Subtotal Control Investments</b>   |   |          |     | \$ 927,111    | \$ 7,427,111  | \$ 1.08 |
| <b>Other Investments</b>  | Various   |          |     | \$ 491,136    | \$ 62,626     | \$ 0    |
|   | <b>Total portfolio investments</b>  |          |     | \$ 13,408,682 | \$ 23,931,861 | \$ 3.51 |

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**RAND CAPITAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED SCHEDULE OF PORTFOLIO INVESTMENTS**

**December 31, 2011 (Continued)**

**NOTES TO CONSOLIDATED SCHEDULE OF PORTFOLIO INVESTMENTS**

- (a) At December 31, 2011 restricted securities represented 100% of the value of the investment portfolio. Restricted securities are subject to one or more restrictions on resale and are not freely marketable. Freed Maxick CPAs, P.C. has not examined the business descriptions of the portfolio companies. Individual securities with values less than \$100,000 are included in Other Investments.
- (b) The Date Acquired column indicates the year in which the Corporation acquired its first investment in the company or a predecessor company. Freed Maxick CPAs, P.C. has not audited the date acquired of the portfolio companies.
- (c) The equity percentages estimate the Corporation's ownership interest in the portfolio investment. The estimated ownership is calculated based on the percent of outstanding voting securities held by the Corporation or the potential percentage of voting securities held by the Corporation upon exercise of warrants or conversion of debentures, or other available data. Freed Maxick CPAs, PC has not audited the equity percentages of the portfolio companies. The symbol <1% indicates that the Corporation holds an equity interest of less than one percent.
- (d) The Corporation uses Accounting Standards Codification (ASC) 820 Fair Value Measurements which defines fair value and establishes guidelines for measuring fair value. At December 31, 2011, ASC 820 designates all of the Corporation's investments as Level 3 assets due to their privately held restricted nature. 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 are subject to restrictions on resale, and are valued at fair value as determined by the management of the Corporation and submitted to the Board of Directors for approval. Fair value is considered to be the amount which the Corporation may reasonably expect to receive for portfolio securities when sold on the valuation date. Valuations as of any particular date, however, are not necessarily indicative of amounts which may ultimately be realized as a result of future sales or other dispositions of securities and these favorable or unfavorable differences could be material. Among the factors considered in determining the fair value of restricted securities are the financial condition and operating results, projected operations, and other analytical data relating to the investment. Also considered are the market prices for unrestricted securities of the same class (if applicable) and other matters which may have an impact on the value of the portfolio company.
- (e) These investments are non-income producing. All other investments are income producing. Non-income producing investments have not generated cash payments of interest or dividends within the last twelve months.
- (f) As of December 31, 2011, the total cost of investment securities approximated \$13.4 million. Net unrealized appreciation was approximately \$10.5 million, which was comprised of \$11.2 million of unrealized appreciation of investment securities and \$0.7 million related to unrealized depreciation of investment securities.
- (g) Rand Capital SBIC, Inc. investment.
- (h) Reduction in cost and value from previously reported balances reflects current principal repayment.



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- (i) Represents interest due (amounts over \$50,000 net of reserves) from investment included as interest receivable on the Corporation's Balance Sheet.
- (j) Non-Control/Non-Affiliate investments are investments that are neither Control Investments nor Affiliated Investments.
- (k) Affiliate investments are defined by the Investment Company Act of 1940, as amended ( 1940 Act ), as those Non-Control investments in companies in which between 5% and 25% of the voting securities are owned.
- (l) Control investments are defined by the 1940 Act as investments in companies in which more than 25% of the voting securities are owned or where greater than 50% of the board representation is maintained.

**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****SCHEDULES OF SELECTED PER SHARE DATA AND RATIOS****For the Five Years Ended December 31, 2011, 2010, 2009, 2008 and 2007**

Selected data for each share of common stock outstanding throughout the five most current years is as follows:

|   | Year Ended December 31, |               |               |               |               |
|---|-------------------------|---------------|---------------|---------------|---------------|
|   | 2011                    | 2010          | 2009          | 2008          | 2007          |
| <b>Income from investment operations (1):</b>                       |                         |               |               |               |               |
| Investment income   | \$ 0.19                 | \$ 0.12       | \$ 0.28       | \$ 0.31       | \$ 0.40       |
| Expenses  | 0.24                    | 0.34          | 0.30          | 0.30          | 0.29          |
| Investment (loss) gain before income taxes                          | (0.05)                  | (0.22)        | (0.02)        | 0.01          | 0.11          |
| Income tax (benefit) expense  | (0.04)                  | (0.08)        | (0.01)        | (0.01)        | 0.04          |
| Net investment (loss) gain  | (0.01)                  | (0.14)        | (0.01)        | 0.02          | 0.07          |
| Issuance of common stock  | 0.00                    | 0.00          | 0.61          | 0.00          | 0.00          |
| Cumulative effect adjustments for uncertain tax positions ASC 740   | 0.00                    | 0.00          | 0.00          | 0.00          | 0.06          |
| Net realized and unrealized gain (loss) on investments              | 0.21                    | 0.12          | (0.11)        | 0.05          | 0.41          |
| Increase (decrease) in net asset value                              | 0.20                    | (0.02)        | 0.49          | 0.07          | 0.54          |
| Net asset value, beginning of year based on weighted average shares | 3.38                    | 3.40          | 3.54          | 3.47          | 2.93          |
| Net asset value, end of year based on weighted average shares       | \$ 3.58                 | \$ 3.38       | \$ 4.03       | \$ 3.54       | \$ 3.47       |
| Per share market value, end of year                                 | \$ 3.10                 | \$ 3.23       | \$ 3.98       | \$ 3.50       | \$ 3.60       |
| Total return based on market value                                  | (4.02)%                 | (18.84)%      | 13.71%        | (2.78)%       | 2.86%         |
| Total return based on net asset value                               | 5.85%                   | (0.67)%       | (3.74)%       | 2.1%          | 18.1%         |
| <b>Supplemental data:</b>   |                         |               |               |               |               |
| Ratio of expenses before income taxes to average net assets         | 7.00%                   | 10.24%        | 8.52%         | 8.60%         | 9.02%         |
| Ratio of expenses including taxes to average net assets             | 5.79%                   | 7.87%         | 8.35%         | 9.10%         | 10.41%        |
| Ratio of net investment (loss) gain to average net assets           | (0.34)%                 | (4.21)%       | (0.29)%       | 0.68%         | 2.18%         |
| Portfolio turnover  | 11.7%                   | 16.5%         | 11.3%         | 6.0%          | 8.6%          |
| Net assets end of year  | \$ 24,399,121           | \$ 23,050,818 | \$ 23,205,881 | \$ 20,226,966 | \$ 19,817,823 |
| Weighted average shares outstanding at end of year                  | 6,818,934               | 6,818,934     | 6,115,081     | 5,718,934     | 5,718,934     |

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

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**RAND CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Business** Rand Capital Corporation ( Rand ) was incorporated under the law of New York on February 24, 1969 and is headquartered in Buffalo, New York. Rand's investment strategy is to seek capital appreciation through venture capital investments in small, unseasoned, developing companies, primarily in the northeastern United States. Rand operates as a publicly-held venture capital company, listed on the NASDAQ Capital Market under the symbol RAND .

Beginning in 1971, Rand operated as a publicly traded, closed-end, diversified management company that was registered under Section 8 of the Investment Company Act of 1940 (the 1940 Act ). In 2001 Rand elected to be treated as a business development company ( BDC ) under the 1940 Act. In 2002 Rand formed a wholly-owned subsidiary for the purpose of operating it as a small business investment company ( SBIC ) licensed by the U.S. Small Business Administration ( SBA ). The subsidiary received an SBA license to operate as an SBIC in August 2002. The subsidiary, which had been organized as a Delaware limited partnership, was converted into a New York corporation on December 31, 2008, at which time its operations as a licensed BDC were continued by a newly formed corporation, Rand Capital SBIC, Inc. ( Rand SBIC ). As of December 31, 2011, the Corporation had \$4,000,000 in SBA leverage. (see Note 5).

**Principles of Consolidation** The consolidated financial statements include the accounts of Rand, its wholly-owned subsidiary Rand SBIC, and the predecessor wholly-owned limited partnership (collectively, the Corporation ). All intercompany accounts and transactions have been eliminated in consolidation.

**Reclassification** Certain prior year amounts in the stockholders' equity section of the Statement of Financial Position have been reclassified to reflect the income tax effect which is consistent with the presentation on the Statement of Operations. In addition, certain balance sheet and income statement amounts have been reclassified to comply with regulatory rules.

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

**Investment Classification** In accordance with the provisions of the 1940 Act, the Corporation classifies its investments by level of control. Under the 1940 Act Control Investments are investments in those companies that the Corporation is deemed to Control. The Corporation is deemed to control a portfolio company if it owns more than 25% of the voting securities of the company or has greater than 50% representation on the company's board. Affiliate Investments are those non-control companies in which the Corporation owns between 5% and 25% of the voting securities. Non-Control/Non-Affiliate Investments are those companies that are neither Control Investments nor Affiliate Investments.

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

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**RAND CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

In September 2006 the Financial Accounting Standards Board ( FASB ) issued guidance on Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ( GAAP ), and expands disclosures about fair value measurements. On January 1, 2008, the Corporation adopted Accounting Standards Codification (ASC) 820.

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

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

Loan and debt securities are valued at cost when it is representative of the fair value of an investment or sufficient assets or liquidation proceeds exists from a sale of a portfolio company at its estimated fair value.

The loan and debt securities may also be valued at an amount other than the price the security would command in order to provide a yield to maturity equivalent to the current yield of similar debt securities. A loan or debt instrument may be reduced in value if it is judged to be of poor quality, collection is in doubt or insufficient liquidation proceeds exist.

Equity securities may be valued using the market approach or income approach. The market approach uses observable prices and other relevant information generated by similar market transactions. It may include the use of market multiples derived from a set of comparables to assist in pricing the investment. Additionally, the Corporation adjusts valuations if a subsequent significant equity financing has occurred that includes a meaningful portion of the financing by a sophisticated, unrelated new investor. The income approach employs a cash flow and discounting methodology to value an investment.

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

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

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

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

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

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

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



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**RAND CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

Certain investment agreements require the portfolio companies to meet compliance covenants. These covenants are generally of a non-financial nature related to reporting to investors, but may include certain financial requirements for interest and principal repayments. At December 31, 2011, none of the Corporation's portfolio investments were in violation of their loan covenants.

**Realized Gain or Loss and Unrealized Appreciation or Depreciation of Investments** Amounts reported as realized gains and losses are measured by the difference between the proceeds from the sale or exchange and the cost basis of the investment without regard to unrealized gains or losses recorded in prior periods. The cost of securities that have, in management's judgment, become worthless are written off and reported as realized losses when appropriate. Unrealized appreciation or depreciation reflects the difference between the valuation of the investments and the cost basis of the investments.

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

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

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

**Original Issue Discount** Investments may include original issue discount or OID income. This occurs when the Corporation purchases a warrant and a note from a portfolio company simultaneously, which 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 reported net of the OID and the OID is accreted into interest income over the life of the loan. The Corporation recognized \$37,000 in OID income for the year ended December 31, 2011. The Corporation recorded no OID income for the years ended December 31, 2010 and 2009.

**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 during the years ended December 31, 2011, 2010 and 2009 was \$94,878, \$34,490 and \$28,410, respectively. Annual amortization expense for the next five years is estimated to average \$12,000 per year.

**Deferred Revenue** From time to time the Corporation charges application and closing fees in connection with its investments. These fees are deferred and amortized into income over the life of the debt or equity investment. Deferred fees amortized into income for the years ended December 31, 2011, 2010 and 2009 amounted to \$5,650, \$2,461, and \$17,766, respectively. Deferred revenue amortization income is estimated to be \$0 for 2012.

**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.

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**RAND CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**Supplemental Cash Flow Information** Income taxes paid (refunded) during the years ended December 31, 2011, 2010 and 2009 amounted to (\$422,862), \$2,122,611 and (\$83,783), respectively. Interest paid during the years ended December 31, 2011, 2010 and 2009 was \$555,748, \$513,953 and \$472,281, respectively. During 2011, 2010 and 2009, the Corporation converted \$130,459, \$366,282 and \$156,933, respectively, of interest receivable and payment in kind interest (PIK) into equity investments. During the year ended December 31, 2011, the Corporation collected \$367,151 on the Kionix escrow receivable. During the year ended December 31, 2010, the Corporation recorded two escrow receivables of \$957,563 and \$831,420 in connection with the sale of investments. During the year ended December 31, 2009 the Corporation recorded one escrow receivable of \$524,926, in connection with the sale of an investment. The remaining escrow receivables are expected to be received in 2012 and are recorded in the other asset line on the consolidated financial statements.

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

As of December 31, 2011, 73% of the Corporation's total investment value was held in five notes and equity securities. As of December 31, 2010, 75% of the Corporation's total investment value was held in five notes and equity securities.

**Income Taxes** The Corporation has adopted ASC 740, Accounting for Uncertainty in Income Taxes. ASC 740 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. ASC 740 also provides guidance on measurement, recognition of tax benefits, classification, interim period accounting disclosure, and transition requirements in accounting for uncertain tax positions.

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

**Recent Accounting Pronouncement** In May, 2011 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs). This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and IFRS. ASU 2011-04 is required to be applied prospectively in interim and annual periods beginning after December 15, 2011. Early application is not permitted. Management does not anticipate that the implementation of this standard will have a material impact on the process for measuring fair values or on the consolidated financial statements.

**NOTE 2. INVESTMENTS**

At December 31, 2011 all of the Corporation's investments are classified in Level 3 due to their privately held restricted nature and were categorized as follows in the fair value hierarchy:

**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS***Assets Measured at Fair Value on a Recurring Basis*

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

*Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)*

| Description  | Fair Value Measurements Using Significant<br>Unobservable Inputs (Level 3)<br>Venture Capital Investments |                     |                       |                      |
|--|---|---------------------|-----------------------|----------------------|
|  | Loan<br>Investments   | Debt<br>Investments | Equity<br>Investments | Total                |
| <b>Beginning Balance, December 31, 2010, of Level 3 Assets</b>                         | <b>\$ 413,597</b>   | <b>\$ 3,595,326</b> | <b>\$ 15,355,702</b>  | <b>\$ 19,364,625</b> |
| <b>Realized Gains or Losses included in net change in net assets from operations</b>   |   |                     |                       |                      |
| Associates Interactive, LLC (Associates)   |   |                     | (293,518)             | (293,518)            |
| Niagara Dispensing Technologies, Inc.  |   |                     |                       |                      |
| (Niagara Dispensing)   |   | (498,828)           | (1,281,785)           | (1,780,613)          |
| <b>Total Realized Losses</b>   |   | (498,828)           | (1,575,303)           | (2,074,131)          |
| <b>Unrealized gains or losses included in net change in net assets from operations</b> |   |                     |                       |                      |
| Associates   |   |                     | 293,518               | 293,518              |
| Gemcor II, LLC (Gemcor)  |   |                     | 1,300,000             | 1,300,000            |
| Liazon Corporation (Liazon)  |   |                     | 141,801               | 141,801              |
| Niagara Dispensing   |   | 447,328             | 1,281,785             | 1,729,113            |
| Synacor, Inc. (Synacor)  |   |                     | 1,531,999             | 1,531,999            |
| Ultra-Scan Corporation (UltraScan)   |   |                     | (264,836)             | (264,836)            |
| <b>Total Unrealized Gains and Losses</b>   |   | 447,328             | 4,284,267             | 4,731,595            |
| <b>Purchases of Securities/Changes to Securities/Non-cash conversions</b>              |   |                     |                       |                      |
| BinOptics Corporation (Binoptics)  |   |                     | 1,190,569             | 1,190,569            |
| Chequed.com, Inc. (Chequed)  |   | 250,000             | 33,222                | 283,222              |
| Microcision LLC (Microcision)  |   | 97,238              |                       | 97,238               |
| Liazon   |   | 37,000              | 819,999               | 856,999              |
| SOMS Technologies, LLC (SOMS)  |   |                     | 101,945               | 101,945              |
| <b>Total Purchases/Changes to Securities and Non- Cash conversions</b>                 |   | 384,238             | 2,145,735             | 2,529,973            |



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| <b>Repayments of Securities</b>                             |                   |                     |                      |                      |
|---|-------------------|---------------------|----------------------|----------------------|
| Gemcor  | (86,486)          |                     |                      | (86,486)             |
| Liazon  |                   | (500,000)           |                      | (500,000)            |
| NDT Acquisitions, LLC (NDT)                                 |                   |                     | (33,715)             | (33,715)             |
| <b>Total Repayments of Securities</b>                       | <b>(86,486)</b>   | <b>(500,000)</b>    | <b>(33,715)</b>      | <b>(620,201)</b>     |
| <b>Transfers within Level 3</b>                             |                   | <b>(573,500)</b>    | <b>573,500</b>       |                      |
| <b>Transfers in or out of Level 3</b>                       |                   |                     |                      |                      |
| <b>Ending Balance, December 31, 2011, of Level 3 Assets</b> | <b>\$ 327,111</b> | <b>\$ 2,854,564</b> | <b>\$ 20,750,186</b> | <b>\$ 23,931,861</b> |

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## RAND CAPITAL CORPORATION AND SUBSIDIARY

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

| Description  | Fair Value Measurements Using Significant<br>Unobservable Inputs (Level 3)<br>Venture Capital Investments |                     |                       | Total        |
|--|---|---------------------|-----------------------|--------------|
|  | Loan<br>Investments   | Debt<br>Investments | Equity<br>Investments |              |
| Amount of total gains or losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date and reported within the net realized and unrealized gains or losses on investments in the Condensed Consolidated Statement of Operations |   |                     |                       | \$ 4,731,595 |
| Amount of realized losses included in changes in net assets from operations for the period reported above within the net realized and unrealized gains or losses on investments in the Condensed Consolidated Statement of Operations  |   |                     |                       | (2,205,551)  |
| Change in unrealized gains or losses relating to assets still held at reporting date   |   |                     |                       | \$ 2,526,044 |

*Assets Measured at Fair Value on a Recurring Basis*

| Description                       | December 31,<br>2010 | Fair Value Measurements at Reported Date Using<br>Quoted Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) |      |               | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-----------------------------------|----------------------|--|------|---------------|--|
|                                   |                      | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2)  |      |               |  |
| Loan investments                  | \$ 413,597           |  |      | \$ 413,597    |  |
| Debt investments                  | 3,595,326            |  |      | 3,595,326     |  |
| Equity investments                | 15,355,702           |  |      | 15,355,702    |  |
| Total Venture Capital Investments | \$ 19,364,625        | \$ 0   | \$ 0 | \$ 19,364,625 |  |

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**RAND CAPITAL CORPORATION AND SUBSIDIARY**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

*Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)*

| Description   | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Venture Capital Investments |                     |                      | Total                |
|---|---|---------------------|----------------------|----------------------|
|   | Loan Investments  | Debt Investments    | Equity Investments   |                      |
| <b>Beginning Balance, December 31, 2009, of Level 3 Assets</b>                                | <b>\$ 488,104</b>   | <b>\$ 3,487,120</b> | <b>\$ 20,290,423</b> | <b>\$ 24,265,647</b> |
| <b><u>Realized Gains or Losses included in net change in net assets from operations</u></b>   |   |                     |                      |                      |
| Adam  |   |                     | (68,000)             | (68,000)             |
| APF Products Group, Inc. (APF)  |   | (631,547)           |                      | (631,547)            |
| Bioworks Inc. (Bioworks)  |   |                     | (49,830)             | (49,830)             |
| Golden Goal LLC (Golden Goal)   |   | (5,560)             | (637,414)            | (642,974)            |
| GridApp Systems Inc. (GridApp)  |   |                     | 2,719,569            | 2,719,569            |
| Innov-X Systems Inc (Innovex)   |   |                     | 4,403,984            | 4,403,984            |
| Wineisit.com, Inc. (Wineisit)   |   | (721,918)           |                      | (721,918)            |
| <b>Total Realized Gains and Losses</b>  |   | <b>(1,359,025)</b>  | <b>6,368,309</b>     | <b>5,009,284</b>     |
| <b><u>Unrealized gains or losses included in net change in net assets from operations</u></b> |   |                     |                      |                      |
| APF   |   | 631,547             |                      | 631,547              |
| Bioworks  |   |                     | 56,000               | 56,000               |
| Golden Goal   |   | 19,238              | 637,414              | 656,652              |
| GridApp   |   |                     | 295,935              | 295,935              |
| Innovex   |   |                     | (5,050,000)          | (5,050,000)          |
| Niagara Dispensing  |   | (447,327)           | (802,835)            | (1,250,162)          |
| SOMS  |   |                     | 55,717               | 55,717               |
| Wineisit  |   | 721,918             | 100,000              | 821,918              |
| <b>Total Unrealized Gains and Losses</b>  |   | <b>925,376</b>      | <b>(4,707,769)</b>   | <b>(3,782,393)</b>   |
| <b><u>Purchases of Securities</u></b>   |   |                     |                      |                      |
| Chequed   |   | 250,000             |                      | 250,000              |
| EmergingMed.com, Inc. (Emerging Med)  |   | 216,712             |                      | 216,712              |
| GridApp   |   |                     | 481,774              | 481,774              |
| Liazon  |   | 463,000             | 38,200               | 501,200              |
| Mezmeriz, Inc. (Mezmeriz)   |   |                     | 21,509               | 21,509               |
| Microcision   |   | 923,472             |                      | 923,472              |
| Mid America Brick (Mid America)   |   |                     | 800,000              | 800,000              |
| Niagara Dispensing  |   | 261,918             |                      | 261,918              |
| Rheonix, Inc. (Rheonix)   |   |                     | 500,000              | 500,000              |
| SOMS  |   | 15,897              |                      | 15,897               |
| <b>Total Purchases of Securities</b>  |   | <b>2,130,999</b>    | <b>1,841,483</b>     | <b>3,972,482</b>     |

**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

| Description   | Fair Value Measurements Using Significant<br>Unobservable Inputs (Level 3)<br>Venture Capital Investments |                     |                       | Total                 |
|---|---|---------------------|-----------------------|-----------------------|
|   | Loan<br>Investments   | Debt<br>Investments | Equity<br>Investments |                       |
| <b>Repayments of Securities</b>   |   |                     |                       |                       |
| Bioworks  |   |                     | (6,170)               | (6,170)               |
| Gemcor  | (74,508)  | (35,778)            |                       | (110,286)             |
| Golden Goal   |   | (32,678)            |                       | (32,678)              |
| GridApp   |   |                     | (4,297,277)           | (4,297,277)           |
| Innovex   |   | (250,000)           | (5,403,984)           | (5,653,984)           |
| Minor difference  | 1   | (1)                 |                       |                       |
| <b>Total Repayments of Securities</b>   | <b>(74,507)</b>   | <b>(318,457)</b>    | <b>(9,707,431)</b>    | <b>(10,100,395)</b>   |
| <b>Transfers within Level 3</b>   |   | <b>(1,270,687)</b>  | <b>1,270,687</b>      |                       |
| <b>Transfers in or out of Level 3</b>   |   |                     |                       |                       |
| <b>Ending Balance, December 31, 2010, of Level 3 Assets</b>   | <b>\$ 413,597</b>   | <b>\$ 3,595,326</b> | <b>\$ 15,355,702</b>  | <b>\$ 19,364,625</b>  |
| <b>Amount of total gains or losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date and reported within the net realized and unrealized gains or losses on investments in the Condensed Consolidated Statement of Operations</b> |   |                     |                       | <b>(\$ 3,736,642)</b> |
| Amount of realized gains and losses included in changes in net assets from operations for the period above reported within the net realized and unrealized gains or losses on investments in the Condensed Consolidated Statement of Operations   |   |                     |                       | 4,962,742             |
| Change in unrealized gains or losses relating to assets still held at reporting date  |   |                     |                       | \$ 1,226,100          |

**NOTE 3. OTHER ASSETS**

At December 31, 2011 and 2010 other assets was comprised of the following:

|  | 2011                | 2010                |
|--|---------------------|---------------------|
| Escrow receivable from GripApp Systems, Inc. | \$ 957,563          | \$ 957,563          |
| Escrow receivable from Innov-X Systems, Inc. | 700,000             | 831,420             |
| Escrow receivable from Kionix, Inc.          | 157,775             | 524,926             |
| Deferred debenture costs                     | 159,744             | 174,621             |
| Property, plant and equipment (net)          | 294                 | 3,609               |
| Operating receivables                        | 77                  | 69,250              |
| <b>Total other assets</b>                    | <b>\$ 1,975,453</b> | <b>\$ 2,561,389</b> |

In 2010 the Corporation sold its investment in Innov-X Systems, Inc. (Innovex) and GridApp Systems, Inc. (GripApp) and a portion of the sales proceeds were held in escrow. Both of these escrow amounts are expected to be released in 2012. An adjustment was made during 2011 to the Innovex escrow receivable balance.

In 2009 the Corporation sold its equity interest in Kionix, Inc. and a portion of the proceeds were held in escrow. The Corporation received a part of the escrow during 2011 and the remainder is expected to be released in 2012.

**NOTE 4. INCOME TAXES**

Deferred tax assets and liabilities are recorded for temporary differences between the financial statement and tax bases of assets and liabilities using the tax rate expected to be in effect when the taxes are actually paid or recovered.

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The tax effect of the major temporary differences and carryforwards that give rise to the Corporation's net deferred tax assets and (liabilities) at December 31, 2011 and 2010 are approximately as follows:

|                             | 2011         | 2010           |
|-----------------------------|--------------|----------------|
| Operations                  | \$ 1,167,000 | \$ 975,000     |
| Investments                 | (3,933,000)  | (2,147,000)    |
| Tax credit carryforwards    | 82,000       | 128,000        |
| Deferred tax liability, net | \$ 2,684,000 | \$ (1,044,000) |

The Company assesses annually the recoverability of its deferred tax assets to determine if a valuation allowance is necessary. In performing this assessment, it considers estimated future taxable income and ongoing tax planning strategies. No allowance was deemed necessary for 2011 and 2010.

The components of income tax expense (benefit) reported in the statements of operations are as follows for the years ended December 31:

|                  | 2011           | 2010                | 2009                |
|------------------|----------------|---------------------|---------------------|
| <b>Current:</b>  |                |                     |                     |
| Federal          | (761,492)      | \$ 588,654          | \$ 1,200,502        |
| State            | (69,413)       | 36,566              | 69,638              |
|                  | (830,905)      | 625,220             | 1,270,140           |
| <b>Deferred:</b> |                |                     |                     |
| Federal          | 1,370,949      | (755,713)           | (1,528,770)         |
| State            | 268,375        | (8,972)             | (152,230)           |
|                  | 1,639,324      | (764,685)           | (1,681,000)         |
| <b>Total</b>     | <b>808,419</b> | <b>\$ (139,465)</b> | <b>\$ (410,860)</b> |

A reconciliation of the expense (benefit) for income taxes at the federal statutory rate to the expense reported is as follows:

|  | 2011         | 2010         | 2009           |
|--|--------------|--------------|----------------|
| Net investment gain, realized gain and unrealized gain before income tax expense | \$ 2,156,722 | \$ (294,528) | \$ (1,150,280) |
| Expected tax expense at statutory rate   | \$ 733,285   | \$ (100,140) | \$ (391,095)   |
| State - net of federal effect  | 133,061      | 18,213       | (54,511)       |
| Pass-through benefit from Portfolio Investment                                   | (18,025)     | (37,214)     | (44,052)       |
| Non-deductible restructuring costs   |              |              | 43,439         |
| Realized losses  |              | (16,857)     |                |

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|                             |                   |                     |                     |
|-----------------------------|-------------------|---------------------|---------------------|
| Dividend Received Deduction | (44,033)          |                     |                     |
| Other                       | 4,131             | (3,467)             | 35,359              |
| <b>Total</b>                | <b>\$ 808,419</b> | <b>\$ (139,465)</b> | <b>\$ (410,860)</b> |

At December 31, 2011 and 2010 the Corporation no longer had any federal net operating loss carryforwards or capital loss carryforwards. For state tax purposes, there is a net operating loss carryforward of \$25,434. A deferred tax asset has been established for this carryforward. For state tax purposes the Corporation had a NYS Qualified Emerging Technology Company (QETC) tax credit carryforward of \$124,490 and \$172,369 at December 31, 2011 and 2010. The QETC credit carryforward does not have an expiration date. The Corporation also has a Georgia Employer's Jobs Tax Credit carryforward of \$22,011 and \$22,011 at December 31, 2011 and 2010 and this credit expires in the next four to seven years.

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A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follow:

|   |           |
|---|-----------|
| Balance at December 31, 2008                                  | \$ 29,500 |
| Increases for positions taken in prior years                  | 66,000    |
| Balance at December 31, 2009                                  | 95,500    |
| Decreases for settlements with taxing authorities             | (23,000)  |
| Balance at December 31, 2010                                  | \$ 72,500 |
| Increases for positions taken in prior years                  | 64,000    |
| Decreases for lapses in the applicable statute of limitations | (64,000)  |
| Balance at December 31, 2011                                  | \$ 72,500 |

The total amount of unrecognized tax benefits at December 31, 2011 was \$72,500, all of which would affect the effective tax rate if recognized. The Corporation does not expect that the amounts of uncertain tax positions will change significantly within the next 12 months.

The Corporation is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ending December 31, 2008 through 2011. In general, the Corporation's state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2007 through 2011.

It is the Corporation's policy to include interest and penalties related to income tax liabilities in income tax expense on the Statement of Operations. There was no amount recognized for interest and penalties related to unrecognized tax benefits for the years ended December 31, 2011 and 2010. The amount recognized for interest and penalties related to unrecognized tax benefit was \$6,300 for the year ended December 31, 2009.

**NOTE 5. SBA DEBENTURE OBLIGATIONS**

At December 31, 2011 and 2010, Rand SBIC had debentures payable to and guaranteed by the SBA totaling \$4,000,000 and \$10,000,000, respectively. During 2011, the Corporation repaid \$6,000,000 of its outstanding SBA leverage and contributed \$1,000,000 of additional regulatory capital to the Rand SBIC, Inc. subsidiary.

The debenture terms require semiannual payments of interest at annual interest rates ranging from 4.108% to 5.535%, plus an annual charge that ranged from .285% to .887% during the year ended December 31, 2011. The debentures have fixed interest rates and a 10 year maturity date. The debentures outstanding at December 31, 2011 will mature as follows:

| Maturity Date     | Leverage     |
|-------------------|--------------|
| 2015              | \$ 1,200,000 |
| 2016              | 900,000      |
| 2020              | 1,900,000    |
| Total Outstanding | \$ 4,000,000 |



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The Corporation is required to pay the SBA a commitment fee equal to 1% of the face amount of the SBA leverage reserved as a partial prepayment of the SBA's nonrefundable 3% leverage draw fees. Commitment fees of \$80,000, \$0, and \$19,000 were paid during the years ended December 31, 2011, 2010 and 2009, respectively.

The Corporation has \$8,000,000 in available and undrawn SBA Guaranteed Debenture leverage available at December 31, 2011. The SBA leverage commitment expires in September 2016.

### **NOTE 6. STOCKHOLDERS EQUITY (NET ASSETS)**

At December 31, 2011 and 2010, there were 500,000 shares of \$10.00 par value preferred stock authorized and unissued.

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The Board of Directors has authorized the repurchase of up to 340,946 shares of the Corporation's outstanding common stock on the open market through October 28, 2012 at prices that are no greater than current net asset value.

Summary of change in equity accounts:

|   | <b>Accumulated<br/>Net<br/>Investment<br/>Loss</b> | <b>Undistributed<br/>Net Realized<br/>Gain<br/>Investments</b> | <b>Net Unrealized<br/>on Appreciation<br/>on Investments</b> |
|---|--|--|--|
| <b>Balance, December 31, 2009</b>                     | \$ (4,961,725)                                     | \$ 10,897,390  | \$ 6,049,329   |
| Net increase (decrease) in net assets from operations | (973,189)  | 3,222,688  | (2,404,562)  |
| Reclass of prior year amounts                         | 4,286,796  | (4,286,796)  |  |
| <b>Balance, December 31, 2010</b>                     | \$ (1,648,118)                                     | \$ 9,833,282   | \$ 3,644,767   |
| Net (decrease) increase in net assets from operations | (81,738)   | (1,515,885)  | 2,945,926  |
| <b>Balance, December 31, 2011</b>                     | \$ (1,729,856)                                     | \$ 8,317,397   | \$ 6,590,693   |

**NOTE 7. STOCK OPTION PLANS**

In 2001 the stockholders of the Corporation authorized the establishment of an Employee Stock Option Plan (the "Option Plan"). The Option Plan provides for the award of options to purchase up to 200,000 common shares to eligible employees. In 2002 the Corporation placed the Option Plan on inactive status as it developed a new profit sharing plan for the Corporation's employees in connection with the establishment of its SBIC subsidiary. As of December 31, 2011, 2010 and 2009, no stock options had been awarded under the Option Plan. Because Section 57(n) of the 1940 Act prohibits maintenance of a profit sharing plan for the officers and employees of a BDC where any option, warrant or right is outstanding under an executive compensation plan, no options will be granted under the Option Plan while any profit sharing plan is in effect with respect to the Corporation (See Note 8).

**NOTE 8. EMPLOYEE BENEFIT PLANS**

The Corporation has a defined contribution 401(k) Plan (the "401K Plan"). The 401K Plan provides a base contribution of 1% for eligible employees and also provides up to 5% matching contributions. The 401K Plan expense was \$21,579, \$36,143 and \$25,743 during the years ended December 31, 2011, 2010 and 2009, respectively.

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

There were no amounts earned pursuant to the Plan for the year ended December 31, 2011. During the year ended December 31, 2010 the Corporation approved and accrued \$584,634 under the profit sharing plan, of which \$568,694 was paid during the year ended December 31, 2011. The associated benefits on the profit sharing had also been accrued at December 31, 2010. The remaining \$15,940 accrued at December 31, 2011 is related to an escrow receivable and will be paid when the escrow is collected. During the year ended December 31, 2009,

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the Corporation approved and accrued \$133,013 under the Plan, which was paid during the year ended December 31, 2010. The amounts approved do not exceed the defined limits.

**Table of Contents****RAND CAPITAL CORPORATION AND SUBSIDIARY****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****NOTE 9. COMMITMENTS AND CONTINGENCIES**

The Corporation has an agreement which provides health benefits for the spouse of a former officer of the Corporation. Remaining payments projected to be paid to the surviving spouse have been fully accrued. Total accrued health benefits under this agreement at December 31, 2011 and 2010 were \$29,772 and \$35,722, respectively.

The Corporation has a lease for office space which expires in December 2015. Rent expense under this operating lease for the years ended December 31, 2011, 2010 and 2009 was \$17,181, \$15,950 and \$18,490. The future operating lease obligations for the next four years are approximately \$17,160, \$17,520, \$17,880 and \$18,240.

**NOTE 10. QUARTERLY OPERATIONS AND EARNINGS DATA UNAUDITED**

|   | 4th<br>Quarter | 3rd<br>Quarter | 2nd<br>Quarter | 1st<br>Quarter |
|---|----------------|----------------|----------------|----------------|
| <b>2011</b>   |                |                |                |                |
| Investment income                                     | \$ 376,062     | \$ 440,437     | \$ 247,713     | \$ 228,140     |
| Net increase (decrease) in net assets from operations | 564,374        | 972,240        | 33,349         | (221,660)      |
| Basic and diluted net increase (decrease) in          |                |                |                |                |
| net assets from operations per share                  | 0.09           | 0.14           | 0.00           | (0.03)         |
| <b>2010</b>   |                |                |                |                |
| Investment income                                     | \$ 233,039     | \$ 227,430     | \$ 198,428     | \$ 188,386     |
| Net increase (decrease) in net assets from operations | 884,569        | (216,627)      | (143,740)      | (679,265)      |
| Basic and diluted net increase (decrease) in          |                |                |                |                |
| net assets from operations per share                  | 0.13           | (0.03)         | (0.02)         | (0.10)         |

**NOTE 11. ALLOWANCE FOR DOUBTFUL ACCOUNTS**

The Corporation maintains an allowance for doubtful accounts for estimated uncollectible interest payments due from portfolio investments. The allowance for doubtful accounts is based on a review of the overall condition of the receivable balances and a review of past due amounts. Changes in the allowance for doubtful accounts consist of the following:

|                              | 2011         | 2010         | 2009         |
|------------------------------|--------------|--------------|--------------|
| Balance at beginning of year | (\$ 158,245) | (\$ 209,089) | (\$ 122,817) |
| Provision for losses         |              |              | (87,089)     |
| Write offs/Recoveries        | 36,245       | 50,844       | 817          |
| Balance at end of year       | (\$ 122,000) | (\$ 158,245) | (\$ 209,089) |

**NOTE 12. SUBSEQUENT EVENTS**

Subsequent to the year ended December 31, 2011, the Corporation:

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Participated in two follow on investments totaling \$505,728.

Synacor, Inc. completed an Initial Public Offering (IPO) at \$5.00 on February 10, 2012 trading on the NASDAQ Global Market under the symbol SYNC . The Corporation owned 986,187 shares prior to the IPO and sold 83,825 shares after the IPO.

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**RAND CAPITAL CORPORATION AND SUBSIDIARY**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

Paid down \$3,100,000 in SBA Guaranteed Debenture leverage in March 2012.

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**RAND CAPITAL CORPORATION AND SUBSIDIARY**  
**SCHEDULE OF CONSOLIDATED CHANGES IN INVESTMENTS AT**  
**COST AND REALIZED LOSS**  
**For the Year Ended December 31, 2011**

|  | Cost<br>Increase<br>(Decrease) | Realized<br>(Loss)    |
|--|--------------------------------|-----------------------|
| <b>New and additions to previous investments</b>   |                                |                       |
| BinOptics Corporation                              | \$ 1,190,569                   | \$                    |
| Liazon Corporation                                 | 856,999                        |                       |
| Chequed.com, Inc.                                  | 283,222                        |                       |
| SOMS Technologies, LLC                             | 101,945                        |                       |
| Microcision LLC                                    | 97,238                         |                       |
|  | 2,529,973                      |                       |
| <b>Investments repaid, sold or liquidated</b>      |                                |                       |
| Niagara Dispensing Technologies, Inc realized loss | (1,780,613)                    | (\$ 1,780,613)        |
| Liazon Corporation repayment                       | (500,000)                      |                       |
| Associates Interactive, LLC realized loss          | (293,518)                      | (293,518)             |
| Gemcor LLC repayment                               | (86,486)                       |                       |
| NDT Acquisitions LLC repayment                     | (33,715)                       |                       |
| Innov-X Systems Inc. escrow adjustment             |                                | (131,420)             |
|  | (2,694,332)                    | (\$ 2,205,551)        |
| <b>Net change in investments</b>                   | <b>(\$ 164,359)</b>            | <b>(\$ 2,205,551)</b> |

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

Rand Capital Corporation and Subsidiaries

We have audited the accompanying consolidated statements of financial position of Rand Capital Corporation and Subsidiaries (the Corporation) as of December 31, 2011 and 2010, including the consolidated schedule of portfolio investments as of December 31, 2011, and the related consolidated statements of operations, cash flows and changes in net assets for each of the three years in the period ended December 31, 2011, and the selected per share data and ratios for each of the five years in the period then ended. These consolidated financial statements and the selected per share data and ratios are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements and selected per share data and ratios based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and selected per share data and ratios are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included examination or confirmation of securities owned as of December 31, 2011 and 2010. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2011 and 2010, the results of their operations, their cash flows and the changes in their net assets for each of the three years in the period ended December 31, 2011, and the selected per share data and ratios for each of the five years in the period then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1, the investment securities included in the consolidated financial statements valued at \$23,931,861 (98% of net assets) and \$19,364,625 (84% of net assets) as of December 31, 2011 and 2010, respectively. As of December 31, 2011, these securities fair values have been estimated by management in the absence of readily ascertainable market value. The fair value estimates are then approved by the Board of Directors. We have reviewed the procedures used by management in preparing the valuations of investment securities and have inspected the underlying documentation, and in the circumstances we believe the procedures are reasonable and the documentation appropriate. Those estimated values may differ from the values that would have been used had a ready market for the investments existed.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary schedule of consolidated changes in investments at cost and realized loss for the year ended December 31, 2011 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. The supplemental schedule is the responsibility of Corporation's management. Such schedule has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

/s/ FREED MAXICK CPAs, P.C.

(Formerly Known as Freed Maxick & Battaglia, CPAs, PC)

Buffalo, New York

March 15, 2012



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**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None

**Item 9A. *Controls and Procedures***

*Management report on Internal Control Over Financial Reporting.* The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control system is a process designed to provide reasonable assurance to the Corporation's management and board of directors regarding the preparation and fair presentation of published financial statements.

Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework. Based on its assessment, management believes that, as of December 31, 2011, the Corporation's internal control over financial reporting is effective based on those criteria.

*Disclosure Controls and Procedures.* The Corporation maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that this information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. The Chief Executive Officer and the Chief Financial Officer carried out an evaluation of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures as of December 31, 2011. Based on the evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's controls and procedures were effective as of December 31, 2011.

This annual report does not include an attestation report of the Corporation's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

*Changes in Internal Control over Financial Reporting.* There have been no significant changes in our internal control or in other factors that could significantly affect those controls subsequent to our evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

**Item 9B. *Other Information***

None

**Part III**

**Item 10. *Directors, Executive Officers, and Corporate Governance***

Information in response to this Item is incorporated herein by reference to the information under the headings PROPOSAL 1 ELECTION OF DIRECTORS, COMMITTEES AND MEETING DATA, and Section 16(a) Beneficial Ownership Compliance provided in the Corporation's definitive Proxy Statement for its Annual Meeting of Shareholders to be held April 26, 2012, to be filed under Regulation 14A (the 2012 Proxy Statement).

The Corporation has adopted a written Code of Ethics that applies to our principal executive officer, principal financial officer and vice president of finance, and a Business Ethics Policy applicable to the Corporation's directors, officers and employees. The Corporation's Code of Ethics and Business Ethics Policy are available, free of charge, in the Governance section of the Corporation's website located at [www.randcapital.com](http://www.randcapital.com).

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**Item 11. *Executive Compensation***

Information in response to this Item is incorporated herein by reference to the information provided in the Corporation's 2012 Proxy Statement under the headings "COMPENSATION DISCUSSION AND ANALYSIS" and "DIRECTOR COMPENSATION."

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information in response to this Item is incorporated herein by reference to the information provided in the Corporation's 2012 Proxy Statement under the heading "BENEFICIAL OWNERSHIP OF SHARES."

**Item 13. *Certain Relationships and Related Transactions and Director Independence***

Information in response to this Item is incorporated herein by reference to the information in the Corporation's 2012 Proxy Statement under the heading "DIRECTOR INDEPENDENCE."

**Item 14. *Principal Accountant Fees and Services***

Information concerning the Corporation's independent auditors, the audit committee's pre-approval policy for audit services and our principal accountant fees and services is contained in the Corporation's 2012 Proxy Statement under the heading "INDEPENDENT ACCOUNTANT FEES."

**Part IV**

**Item 15. *Exhibits, Financial Statement Schedules***

(a) The following documents are filed as part of this report and included in Item 8:

(1) CONSOLIDATED FINANCIAL STATEMENTS

Statements of Financial Position as of December 31, 2011 and 2010

Statements of Operations for the three years in the period ended December 31, 2011

Statements of Changes in Net Assets for the three years in the period ended December 31, 2011

Statements of Cash Flows for the three years in the period ended December 31, 2011

Schedule of Portfolio Investments as of December 31, 2011

Schedules of Selected Per Share Data and Ratios for the five years in the period ended December 31, 2011

Notes to the Consolidated Financial Statements

Supplemental Schedule of Consolidated Changes in Investments at Cost and Realized Loss for the year ended December 31, 2011

Report of Independent Registered Public Accounting Firm

(2) FINANCIAL STATEMENT SCHEDULES

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The required financial statement Schedule II Valuation and Qualifying Accounts has been omitted because the information required is included in the note 11 to the consolidated financial statements.

- (b) 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.

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- (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 Appendix B to the Corporation's definitive Proxy Statement filed on June 1, 2002.\*
- (10.2) Certificate of Incorporation of Rand Merger Corporation as filed by the NY Department of State on 12/18/08 incorporated by reference to Exhibit 1(a) to Registration Statement No. 811-22276 on Form N-5 of Rand Capital SBIC, Inc. filed with the SEC on 2/6/09.
- (10.3) By-laws of Rand Capital SBIC, Inc. incorporated by reference to Exhibit 2 to Registration Statement No. 811-22276 on Form N-5 of Rand Capital SBIC, Inc. filed with the SEC on 2/6/09.
- (10.4) Certificate of Merger of Rand Capital SBIC, L.P. and Rand Capital Management, LLC into Rand Merger Corporation, as filed by the NY Department of State on 12/18/08 incorporated by reference to Exhibit 1(b) to Registration Statement No. 811-22276 on Form N-5 of Rand Capital SBIC, Inc. filed with the SEC on 2/6/09.
- (10.5) Rand Capital Corporation Amended and Restated Profit Sharing Plan applicable to Rand Capital SBIC, Inc. incorporated by reference to Exhibit 7 to Registration Statement No. 811-22276 on Form N-5 of Rand Capital SBIC, Inc. filed with the SEC on 2/6/09.\*
- (31.1) Certification of Principal 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 Principal Financial Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended filed herewith
- (32.1) Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Rand Capital Corporation furnished herewith
- (32.2) Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Rand Capital SBIC, Inc. furnished 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-K to be signed on its behalf by the undersigned thereunto duly authorized.**

Date: March 15, 2012

RAND CAPITAL CORPORATION

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

**Pursuant to the requirements of the Securities Exchange Act of 1934, this Report on Form 10-K has been signed below by the following persons on behalf of the Corporation in the capacities and on the date indicated.**

| Signature   | Title     |                |
|---|-----------|----------------|
| <b>(i) Principal Executive Officer:</b>                   |           |                |
| <i>/s/ Allen F. Grum</i><br>Allen F. Grum                 | President | March 15, 2012 |
| <b>(ii) Principal Accounting &amp; Financial Officer:</b> |           |                |
| <i>/s/ Daniel P. Penberthy</i><br>Daniel P. Penberthy     | Treasurer | March 15, 2012 |
| <b>(iii) Directors:</b>                                   |           |                |
| <i>/s/ Allen F. Grum</i><br>Allen F. Grum                 | Director  | March 15, 2012 |
| <i>/s/ Erland E. Kailbourne</i><br>Erland E. Kailbourne   | Director  | March 15, 2012 |
| <i>/s/ Ross B. Kenzie</i><br>Ross B. Kenzie               | Director  | March 15, 2012 |
| <i>/s/ Reginald B. Newman II</i><br>Reginald B. Newman II | Director  | March 15, 2012 |
| <i>/s/ Jayne K. Rand</i><br>Jayne K. Rand                 | Director  | March 15, 2012 |
| <i>/s/ Robert M. Zak</i><br>Robert M. Zak                 | Director  | March 15, 2012 |