

HERCULES TECHNOLOGY GROWTH CAPITAL INC

Form N-2/A

March 24, 2006

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As filed with the Securities and Exchange Commission on March 24, 2006

Registration No. 333-131161

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM N-2**

(Check appropriate box or boxes)

- REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933
- Pre-Effective Amendment No. 3
- Post-Effective Amendment No.

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**HERCULES TECHNOLOGY GROWTH CAPITAL, INC.**

(Exact Name of Registrant as Specified in Charter)

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525 University Avenue, Suite 700

Palo Alto, CA 94301

(650) 289-3060

(Address and Telephone Number of Principal Executive Offices)

Manuel A. Henriquez

Chairman of the Board, President and Chief Executive Officer

**Hercules Technology Growth Capital, Inc.**

**525 University Avenue, Suite 700**

**Palo Alto, California 94301**

(Name and Address of Agent for Service)

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**Approximate Date of Proposed Public Offering:** As soon as practicable after the effective date of this Registration Statement.

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box. "

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**The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the SEC, acting pursuant to said Section 8(a), may determine.**

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**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION, DATED MARCH 24, 2006**

**Up to 3,420,000 Shares of Common Stock**

**Issuable Upon Exercise of Rights to Subscribe for Such Shares**

We are issuing transferable rights to our stockholders of record, or record date stockholders, as of 5:00 p.m., New York City time, on March 24, 2006, or the record date. The rights entitle any holders of rights, or rights holders, including holders of rights acquired during the subscription period, to subscribe for an aggregate of approximately 3,420,000 shares of our common stock. Record date stockholders will receive one right for every three outstanding shares of common stock owned on the record date. The rights entitle the holders to purchase one new share of common stock for every right held, which we refer to as the basic subscription right. In addition, both record date stockholders who fully exercise their rights and holders of rights acquired during the subscription period will be entitled to subscribe for additional shares that remain unsubscribed as a result of any unexercised rights. This oversubscription privilege is subject to a number of limitations, and record date stockholders will have the first priority right to subscribe for such additional shares.

We are a specialty finance company that provides debt and equity growth capital to technology-related companies at all stages of development. We primarily finance privately held companies backed by leading venture capital and private equity firms and also may finance certain publicly traded companies. We originate our investments through our principal office located in the Silicon Valley, as well as additional offices in the Boston, Boulder and Chicago areas. Our goal is to be the capital provider of choice for technology-related and life sciences companies requiring sophisticated and customized financing solutions. We invest primarily in structured mezzanine debt and, to a lesser extent, in senior debt and equity investments. We borrow funds, which we refer to as leverage, to make investments.

Our investment objective is to maximize our portfolio's total return by generating current income from our debt investments and capital appreciation from our equity-related investments. We are an internally-managed, non-diversified closed-end investment company that has elected to be treated as a business development company under the Investment Company Act of 1940.

Our common stock is listed for quotation on the Nasdaq National Market under the symbol HTGC. The rights are transferable, and the rights have been approved for quotation on the Nasdaq National Market under the symbol HTGCR. See The Rights Offering for a complete discussion of the terms of this offer.

The subscription price will be 95% of the volume-weighted average of the sales prices of our shares of common stock on the Nasdaq National Market on the ten trading days ending on the expiration date of the offer. The offer will expire at 5:00 p.m., New York City time, on April 13, 2006, unless extended as described in this prospectus, which date we refer to as the expiration date. The offer will dilute the ownership interest and voting power of the common stock owned by stockholders who do not fully exercise their basic subscription rights. Stockholders who do not fully exercise their basic subscription rights should expect, upon completion of the offer, to own a smaller proportional interest in us than before the offer. Further, if the net proceeds per share from the offering are at a discount to our net asset value per share, the offer will reduce our net

asset value per share.

The net asset value per share of our common stock at February 28, 2006 (the last date prior to the date of this prospectus on which we determined net asset value) was \$11.55, based on net assets of approximately \$113.2 million at February 28, 2006. The net asset value at December 31, 2005, was \$11.67 prior to payment of a \$0.30 per share dividend in January 2006. On March 23, 2006, the last reported sale price of a share of our common stock on the Nasdaq National Market was \$11.33.

**An investment in our common stock is subject to risks and involves a heightened risk of total loss of investment. This offer will dilute the ownership interest and voting power of stockholders who do not fully exercise their basic subscription rights. In addition, the companies in which we invest are subject to special risks. See Risk Factors beginning on page 13 to read about factors you should consider before exercising any rights to subscribe for shares of our common stock.**

**Neither the Securities and Exchange Commission ( SEC ) nor any state securities commission has approved or disapproved of these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

Please read this prospectus before investing, and keep it for future reference. The prospectus contains important information about us that a prospective investor ought to know before investing in our common stock. We file annual, quarterly and current reports, proxy statements and other information about us with the Securities and Exchange Commission. The information is available free of charge by contacting us at 525 University Avenue, Suite 700, Palo Alto, California 94301 or by telephone calling collect at (650) 289-3060 or on our website at www.herculestech.com. The SEC also maintains a website at www.sec.gov that contains such information.

	Per share	Total <sup>(4)</sup>
Estimated subscription price <sup>(1)</sup>	\$ 11.0800	\$ 37,893,600
Estimated sales load <sup>(1)(2)</sup>	\$ 0.4432	\$ 1,515,744
Proceeds, before expenses, to us <sup>(1)(3)</sup>	\$ 10.6368	\$ 36,377,856

- (1) Estimated on the basis of the volume-weighted average of the sales prices of our shares of common stock on the Nasdaq National Market on the ten trading days ending on March 23, 2006. See The Rights Offering The Subscription Price.
- (2) In connection with the offer, A.G. Edwards & Sons, Inc. and JMP Securities, the co-dealer managers for this offer, will receive a fee for financial advisory, marketing and soliciting services equal to 4.0% of the estimated subscription price per share for each share issued pursuant to the exercise of rights. We have also agreed to reimburse the co-dealer managers an aggregate of up to \$75,000 for their expenses incurred in connection with the offer.
- (3) Before deduction of the offering expenses incurred by us, estimated to be \$575,000 including an aggregate of up to \$75,000 to be paid to the co-dealer managers as partial reimbursement for their expenses as discussed in note 2 above.
- (4) Assumes all rights are exercised at the estimated subscription price.

**A.G. EDWARDS**

**JMP SECURITIES**

**The date of this prospectus is March , 2006**

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As a result of the terms of this offer, stockholders who do not fully exercise their rights will own, upon completion of this offer, a smaller proportional interest in us than they owned prior to the offer. In addition, if the net proceeds per share from the offering are less than the net asset value per share, the offer may result in an immediate dilution of net asset value per share for all of our stockholders. Such dilution is not currently determinable because it is not known how many shares will be subscribed for, what the net asset value or market price of our common stock will be on the expiration date of the offer or what the subscription price will be. If the net proceeds per share from the offering are substantially less than the current net asset value per share, such dilution could be substantial. Any such dilution will disproportionately affect non-participating stockholders. If the net proceeds are less than our net asset value per share, then all stockholders will experience a decrease in the net asset value per share held by them, irrespective of whether they exercise all or any portion of their rights. See **Risk Factors** **Risks Related to this Offering** **Your Interest in Us May Be Diluted** in this prospectus for more information.

If you have any questions or need further information about this offer, please call American Stock Transfer & Trust Company, our subscription agent for the offer, at 1-866-669-9888.

**You should rely only on the information contained in this prospectus. We have not authorized any dealer, salesperson or other person to provide you with different information or to make representations as to matters not stated in this prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. This prospectus is not an offer to sell, or a solicitation of an offer to buy, any shares of common stock or rights by any person in any jurisdiction where it is unlawful for that person to make such an offer or solicitation or to any person in any jurisdiction to whom it is unlawful to make such an offer or solicitation. The information in this prospectus is accurate only as of its date, and under no circumstances should the delivery of this prospectus or the sale of any common stock or rights imply that the information in this prospectus is accurate as of any later date or that the affairs of Hercules Technology Growth Capital, Inc. have not changed since the date hereof.**

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**SUMMARY**

*This summary highlights some of the information in this prospectus and may not contain all of the information that is important to you. Accordingly, to understand the offer fully, you are encouraged to read the entire document carefully. You should read carefully the more detailed information set forth under Risk Factors and the other information included in this prospectus. The following summary is qualified in its entirety by reference to the more detailed information and financial statements appearing elsewhere in this prospectus. In this prospectus, unless the context otherwise requires, the Company, Hercules Technology Growth Capital, we, us and our refer to Hercules Technology Growth Capital, Inc. and our wholly-owned subsidiaries Hercules Technology II, L.P. and Hercules Technology SBIC Management, LLC.*

**The Rights Offering**

**The Offer**

We are issuing to stockholders of record, or record date stockholders, on March 24, 2006, the record date, one transferable right for each three shares of our common stock held on the record date (1 for 3). Each holder of the rights, or rights holder, is entitled to subscribe for one share of our common stock for every right held, which we refer to as the basic subscription right. We will not issue fractional rights; we will round up the rights issuable to you to the next whole right.

Rights may be exercised at any time during the subscription period, which commences on March 24, 2006, the record date, and ends at 5:00 p.m., New York City time, on April 13, 2006, the expiration date, unless extended by us. The rights will expire on the expiration date of the offer and may not be exercised thereafter.

The rights are transferable and have been approved for quotation on the Nasdaq National Market under the symbol HTGCR. See The Rights Offering.

**Subscription Price**

The subscription price per share will be 95% of the volume-weighted average of the sales prices of our shares of common stock on the Nasdaq National Market on the ten trading days ending on the expiration date of the offer. Because the subscription price will be determined on the expiration date, rights holders who decide to acquire shares pursuant to their basic subscription rights or pursuant to the over-subscription privilege will not know the actual purchase price of those shares when they make that decision. See The Rights Offering The Subscription Price.

**Over-Subscription Privilege**

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Record date stockholders who fully exercise all rights issued to them are entitled to subscribe for additional shares of our common stock which were not subscribed for by other stockholders, which we refer to as the remaining shares. If sufficient remaining shares of our common stock are available, all record date stockholders' over-subscription requests will be honored in full. In addition, any non-record date rights holder who exercises rights is entitled to subscribe for remaining shares that are not otherwise subscribed for by record date stockholders. Shares acquired pursuant to the over-subscription privilege are subject to certain limitations and allocation. See The Rights Offering Over-Subscription Privilege.

### **Purpose of the Offer**

Our Board of Directors has determined in good faith that the offer would result in a net benefit to the existing stockholders because it increases the equity capital available for making additional investments in technology-related and life sciences companies, and may also be available to pay operating expenses and the potential repayment of debt. In order to continue to execute our investment objective, we must have sufficient



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liquidity available to remain a credible source of capital to our portfolio companies. At our currently anticipated pace of investment activity, and given our current capital commitments, we believe that we will have limited capital available for new investments in 2006 unless we increase our capital resources. The offer gives existing stockholders the right to purchase additional shares at a price that is expected to be below the then-current trading price, while providing us access to additional capital resources. In connection with the approval of this offer, our Board of Directors considered, among other things, the following factors:

the subscription price relative to the market price and to our net asset value per share;

the increased equity capital to be available upon completion of the offer for making additional investments consistent with our investment objective;

the net asset value and ownership dilution to be experienced by non-participating stockholders;

the terms and expenses in connection with the offer relative to other alternatives for raising capital, including fees payable to the co-dealer managers;

the size of the offer in relation to the number of shares outstanding;

the market price of our common stock, both before and after the announcement of the offer; and

the general condition of the securities markets.

We can provide no assurance that the current offer will be successful, or that by increasing the size of our available equity capital our expense ratio will be lowered.

## **Dilutive Effects**

This offer will dilute the ownership interest and voting power of stockholders who do not fully exercise their basic subscription rights. Further, because the net proceeds per share from the offering may be at a discount to our net asset value per share, the offer may reduce our net asset value per share. The amount of dilution that a stockholder will experience could be substantial.

Shares of closed-end investment companies have in the past frequently traded at discounts to their net asset values. This characteristic of closed-end investment companies is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our shares will trade above, at or below our net asset value.

The transferable feature of the rights will afford non-participating stockholders the potential of receiving cash payment upon the sale of the rights, receipt of which may be viewed as partial compensation for the dilution of their interests.

### **Sale of Rights**

The rights are evidenced by a subscription certificate and are transferable until the day immediately preceding the expiration date of the offer (or if the offer is extended, until the day immediately prior to the extended expiration date). The rights have been approved for quotation on the Nasdaq National Market under the symbol HTGCR. While the Company and the co-dealer managers will use their best efforts to ensure that an adequate trading market for the rights will exist, no assurance can be given that a market for the rights will develop. Trading in the rights on the Nasdaq National Market may be conducted until the close of trading on the Nasdaq National Market on the day immediately prior to the expiration date of the offer (or if the offer is extended, until the day immediately prior to the extended expiration date). See The Rights Offering Sale of Rights.

### **Use of Proceeds**

We intend to use the net proceeds from this offer to make investments in technology-related and life sciences companies in accordance with our investment objective, to pay our operating expenses and potentially to repay a portion of our debt. See Use of Proceeds.

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### **How to Obtain Subscription Information**

Contact your broker-dealer, trust company, bank or other nominee where your rights are held, or

Contact the subscription agent, American Stock Transfer & Trust Company, toll-free at 1-866-669-9888.

### **How to Subscribe**

Deliver a completed subscription certificate and payment to the subscription agent by the expiration date of the offer, or

If your shares are held in an account with your broker-dealer, trust company, bank or other nominee, which qualifies as an Eligible Guarantor Institution under Rule 17Ad-15 of the Securities Exchange Act of 1934, as amended, instruct your Eligible Guarantor Institution to deliver a notice of guaranteed delivery to the subscription agent by the expiration date of the offer.

### **Subscription Agent**

American Stock Transfer & Trust Company, which we call the subscription agent, will act as the subscription agent in connection with this offer.

### **Information Agent**

The Altman Group, which we call the information agent, will act as the information agent in connection with this offer. You may contact The Altman Group with questions at 1-800-884-4590.

### **Distribution Arrangements**

A.G. Edwards & Sons, Inc. and JMP Securities will act as co-dealer managers for the offer. Under the terms and subject to the conditions contained in the Dealer Manager Agreement, the co-dealer managers will provide financial advisory services and marketing assistance in connection with the offer and will solicit the exercise of rights and participation in the over-subscription privilege by our stockholders. The offer is not contingent upon any number of rights being exercised. We have agreed to pay the co-dealer managers a fee for their financial advisory, marketing and soliciting services equal to 4.0% of the aggregate subscription price per share for shares issued pursuant to the exercise of rights, including pursuant to the over-subscription privilege. In addition, we have agreed to reimburse the co-dealer managers up to \$75,000 in the aggregate for their expenses incurred in connection with the offer. We have also agreed to indemnify the co-dealer managers against certain liabilities under the Securities Act of 1933.

**Important Dates to Remember**

Record Date	March 24, 2006
Subscription Period	from March 24, 2006 to April 13, 2006 <sup>(1)</sup>
Last Day Rights May Be Traded	April 12, 2006
Expiration Date	April 13, 2006 <sup>(1)</sup>
Deadline for Delivery of Subscription Certificates and Payment for Shares	April 13, 2006 <sup>(1)</sup>
Deadline for Delivery of Notice of Guaranteed Delivery <sup>(2)</sup>	April 11, 2006 <sup>(1)</sup>
Confirmations Mailed to Participants	April 20, 2006 <sup>(1)</sup>
Final Payment for Oversubscription Shares	May 4, 2006 <sup>(1)</sup>

- (1) Unless the offer is extended.
- (2) Participating rights holders must, by the expiration date of the offer (unless the offer is extended), either (i) deliver a subscription certificate and payment for shares or (ii) cause to be delivered on their behalf a notice of guaranteed delivery.

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### **Our Company**

We are a specialty finance company that provides debt and equity growth capital to technology-related and life sciences companies at all stages of development. We primarily finance privately-held companies backed by leading venture capital and private equity firms and also may invest in select publicly-traded companies that lack access to public capital or are sensitive to equity ownership dilution. We source our investments through our principal office located in Silicon Valley, as well as our additional offices in the Boston, Boulder and Chicago areas. Our goal is to be the leading structured mezzanine capital provider of choice for venture capital and private equity backed technology-related and life sciences companies requiring sophisticated and customized financing solutions. We invest primarily in structured mezzanine debt and, to a lesser extent, in senior debt and equity. We use the term structured mezzanine debt investment to refer to any debt investment, such as a senior or subordinated secured loan, that is coupled with an equity component, including warrants, options or rights to purchase common or preferred stock. Our structured mezzanine debt investments will typically be secured by some or all of the assets of the portfolio company.

We focus our investments in companies active in technology industry sub-sectors characterized by products or services that require advanced technologies, including computer software and hardware, networking systems, semiconductors, semiconductor capital equipment, information technology infrastructure or services, Internet consumer and business services, telecommunications, telecommunications equipment, media and life sciences. Within the life sciences sub-sector, we focus on medical devices, bio-pharmaceutical, health care services and information systems companies. We refer to all of these companies as technology-related companies and intend, under normal circumstances, to invest at least 80% of the value of our assets in such businesses.

Our investment objective is to maximize our portfolio's total return by generating current income from our debt investments and capital appreciation from our equity-related investments. We are an internally-managed, non-diversified closed-end investment company that has elected to be treated as a business development company under the Investment Company Act of 1940.

Our primary business objectives are to increase our net income, net operating income and net asset value by investing in structured mezzanine debt and equity of venture capital and private equity backed technology-related companies with attractive current yields and the potential for equity appreciation and realized gains. Our structured debt investments typically include warrants or other equity interests, giving us the potential to realize equity-like returns on a portion of our investment. In some cases, we receive the right to make additional equity investments in our portfolio companies in connection with future equity financing rounds. Capital that we provide directly to venture capital and private equity backed technology-related companies is generally used for growth, and in select cases for acquisitions or recapitalizations.

Our portfolio is comprised of, and we anticipate that our portfolio will continue to be comprised of, investments in technology-related companies at various stages of their development. Our emphasis is on private companies following or in connection with their first institutional round of equity financing, which we refer to as emerging-growth companies, and private companies in later rounds of financing, which we refer to as expansion-stage companies. To a lesser extent, we make investments in established companies comprised of private companies in one of their final rounds of equity financing prior to a liquidity event or select publicly-traded companies that lack access to public capital or are sensitive to equity ownership dilution.

From incorporation through December 31, 2005, we were taxed as a corporation under Subchapter C of the Internal Revenue Code of 1986, as amended, which we refer to in this prospectus as the Code. We currently intend to seek to be treated for federal income tax purposes as a RIC under Subchapter M of the Code with the filing of our federal corporate income tax return for 2006, which election, when actually made, would be effective as of January 1, 2006. As a RIC, we generally will not pay corporate-level federal income taxes on any



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ordinary income or capital gains that we distribute to our stockholders as dividends. We may be required, however, to pay corporate-level federal income taxes on gains built into our assets as of the effective date of our RIC election. See **Certain United States Federal Income Tax Considerations Conversion to Regulated Investment Company Status**. To obtain and maintain the federal income tax benefits of RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually an amount equal to at least 90% of the sum of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of assets legally available for distribution. See **Distributions**. There is no assurance that we will meet these tests and be eligible to make a RIC election. As of the date of this prospectus, we cannot determine the probability that during 2006 we will qualify as a RIC when we file our 2006 tax return. If we do not qualify or elect to make a RIC election, we would continue to be taxed as a C corporation.

We commenced investment operations in September 2004. At December 31, 2005, we had approximately \$171.8 million of outstanding structured mezzanine debt investments in 31 portfolio companies and equity investments of \$4.9 million, for a total investment portfolio at fair value of \$176.7 million. In addition, at December 31, 2005, we had unfunded contractual commitments of \$30.2 million. At February 28, 2006, we had approximately \$173.5 million of outstanding structured mezzanine debt investments in 35 portfolio companies and equity investments of \$4.7 million in 7 companies, for a total investment portfolio at fair value of \$178.2 million, which includes the effect of normal principal amortization and prepayments by certain of our portfolio companies. In addition, at February 28, 2006, we had unfunded contractual commitments of \$59 million.

At December 31, 2005, the weighted average yield to maturity of our loan obligations was approximately 12.87%. Yields to maturity are computed using interest rates as of December 31, 2005 and include amortization of loan facility fees, original issue discounts, commitment fees and market premiums or discounts over the expected life of the debt investments, weighted by their respective costs when averaged and are based on the assumption that all contractual loan commitments have been fully funded.

The following table summarizes our investments in our portfolio companies at fair value as of December 31, 2005.

<b>Company</b>	<b>Principal Business</b>	<b>Fair Value of Investment</b>
Acceleron Pharmaceuticals, Inc.	Biopharmaceuticals	\$ 4,000,593
Guava Technologies, Inc.	Biopharmaceuticals	4,500,948
Labopharm USA, Inc.	Biopharmaceuticals	11,236,688
Merrimack Pharmaceuticals, Inc.	Biopharmaceuticals	9,019,343
Omrix Biopharmaceuticals, Inc.	Biopharmaceuticals	4,760,181
Paratek Pharmaceuticals, Inc.	Biopharmaceuticals	10,031,201
Atrenta, Inc.	Software	5,005,741
Concuity, Inc.	Software	4,567,873
Gomez, Inc.	Software	2,207,542
Inxight Software, Inc.	Software	5,003,014
Metreo, Inc.	Software	1,266,000
Proficiency, Inc.	Software	4,011,907
Sportvision, Inc.	Software	3,526,642
Talisma Corp.	Software	3,422,242
Wageworks, Inc.	Consumer and business products	19,827,725
IKANO Communications, Inc.	Communications and networking	16,517,499
Interwise, Inc.	Communications and networking	2,809,653
Occam Networks, Inc.	Communications and networking	3,195,320
Optovia Corporation	Communications and networking	5,000,000
Pathfire, Inc.	Communications and networking	5,002,626
Adiana, Inc.	Medical devices and equipment	2,510,383

Optiscan Biomedical, Corp.

Medical devices and equipment

2,764,248



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<u>Company</u>	<u>Principal Business</u>	<u>Fair Value of Investment</u>
Power Medical Interventions, Inc.	Medical devices and equipment	4,026,005
Xillix Technologies Corp.	Medical devices and equipment	5,521,190
Affinity Express, Inc.	Internet consumer and business services	2,011,367
Invoke Solutions, Inc.	Internet consumer and business services	1,501,546
RazorGator Interactive Group, Inc.	Internet consumer and business services	5,160,686
Cornice, Inc.	Electronics and computer hardware	12,844,786
Sling Media, Inc.	Electronics and computer hardware	4,910,394
Ageia Technologies	Semiconductors	8,508,104
Cradle Technologies	Semiconductors	2,001,779
	Total investments	<u>\$ 176,673,226</u>

Our management team, which includes Manuel A. Henriquez, our co-founder, Chairman, President and Chief Executive Officer, is currently comprised of 13 professionals who have, on average, more than 15 years of experience in venture capital, structured finance, commercial lending or acquisition finance with the types of technology-related companies that we are targeting. We believe that we can leverage the experience and relationships of our management team to successfully identify attractive investment opportunities, underwrite prospective portfolio companies and structure customized financing solutions.

**Our Market Opportunity**

We believe that technology-related companies compete in one of the largest and most rapidly growing sectors of the U.S. economy and that continued growth is supported by ongoing innovation and performance improvements in technology products as well as the adoption of technology across virtually all industries in response to competitive pressures. We believe that an attractive market opportunity exists for a specialty finance company focused primarily on structured mezzanine investments in technology-related and life-science companies for the following reasons:

***Technology-Related Companies Underserved by Traditional Lenders.*** We believe many viable technology-related companies backed by financial sponsors have been unable to obtain sufficient growth financing from traditional lenders, including financial services companies such as commercial banks and finance companies, in part because traditional lenders have continued to consolidate and have adopted a more risk-averse approach to lending that has resulted in tightened credit standards in recent years. More importantly, we believe traditional lenders are typically unable to underwrite the risk associated with financial sponsor-backed emerging-growth or expansion-stage companies effectively.

***Unfulfilled Demand for Structured Debt Financing by Technology-Related Companies.*** Private debt capital from specialty finance companies continues to be an important source of funding for technology-related companies. We believe that this demand is currently unfulfilled, in part because historically the largest capital providers to technology-related companies have exited the market, while at the same time lending requirements of traditional lenders have become more stringent. We therefore believe we entered the structured lending market at an opportune time.

***Structured Mezzanine Debt Products Complement Equity Financing from Venture Capital and Private Equity Funds.*** We believe that our structured mezzanine debt products will provide an additional source of growth capital for technology-related companies that may otherwise only be able to obtain equity financing through incremental investments by their existing investors. Generally, we believe emerging-growth and

expansion-stage companies target a portion of their capital to be debt in an attempt to achieve a higher valuation through internal growth prior to subsequent equity financing rounds or liquidity events.

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***Lower Valuations for Private Technology-Related Companies.*** During the downturn in technology-related industries that began in 2000, the markets saw sharp and broad declines in valuations of venture capital and private equity-backed technology-related companies. We believe that the valuations currently assigned to these companies in private financing rounds will allow us to build a portfolio of equity-related securities at attractive valuation levels.

### **Our Business Strategy**

Our strategy to achieve our investment objective includes the following key elements:

***Leverage the Experience and Industry Relationships of Our Management Team.*** We have assembled a team of senior investment professionals with extensive experience as venture capitalists, commercial lenders and originators of structured debt and equity investments in technology-related companies. Members of our management team also have operational, research and development and finance experience with technology-related companies. We have established contacts with leading venture capital and private equity fund sponsors, public and private companies, research institutions and other industry participants, which should enable us to identify and attract well-positioned prospective portfolio companies.

***Mitigate Risk of Principal Loss and Build a Portfolio of Equity-Related Securities.*** We expect that our investments will have the potential to produce attractive risk-adjusted returns through current income as well as capital appreciation from our equity-related investments. We believe that we can mitigate the risk of loss on our debt investments through the combination of principal amortization, cash interest payments, relatively short maturities, taking security interests in the assets of our portfolio companies, requiring prospective portfolio companies to have certain amounts of available cash at the time of our investment and the continued support from a venture capital or private equity firm at the time we make our investment. Our debt investments typically include warrants or other equity interests, giving us the potential to realize equity-like returns on a portion of our investment.

***Provide Customized Financing Complementary to Financial Sponsors' Capital.*** We offer a broad range of investment structures and have the flexibility to structure our investments to suit the particular needs of our portfolio companies. We believe that our debt investments will be viewed as an attractive source of capital and that many venture capital and private equity fund sponsors encourage their portfolio companies to use debt financing as a means of potentially enhancing equity returns, minimizing equity dilution and increasing valuations prior to a subsequent equity financing round or a liquidity event.

***Invest at Various Stages of Development.*** We provide growth capital to technology-related companies at all stages of development, which we believe provides us with a broader range of potential investment opportunities than those available to many of our competitors, who generally choose to make investments during a particular stage in a company's development.

***Benefit from Our Efficient Organizational Structure.*** We believe that the perpetual nature of our corporate structure enables us to be a long-term partner for our portfolio companies in contrast to traditional mezzanine and investment funds, which typically have a limited life. In addition, because of our access to the equity markets, we believe that we may benefit from a lower cost of capital than that available to private investment funds.

***Deal Sourcing Through Our Proprietary Database.*** We have developed a proprietary and comprehensive structured query language-based (SQL) database system to track various aspects of our investment process, including sourcing, originations, transaction monitoring and post-investment performance. As of December 31, 2005, our proprietary SQL-based database system included over 7,900 technology-related companies and over 1,480 venture capital private equity sponsor/investors, as well as various other industry contacts.

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### **Distributions**

On December 9, 2005, we declared a dividend of \$0.30 per share for stockholders of record on January 6, 2006. The dividend totaled approximately \$2.9 million and was distributed on January 27, 2006. On October 27, 2005, we declared a dividend of \$0.025 per share for stockholders of record on November 1, 2005. The dividend totaled approximately \$245,000, which was distributed on November 17, 2005. We intend to continue to distribute quarterly dividends to our stockholders. The amount of our quarterly distributions will be determined by our Board of Directors out of assets legally available for distribution. We intend to seek to be treated as a regulated investment company, or a RIC, for United States federal income tax purposes upon the filing of our federal corporate income tax return for 2006, which election, when actually made, would be effective as of January 1, 2006, and as such, to distribute thereafter to our stockholders annually at least 90% of the sum of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any. However, such an election and qualification to be treated as a RIC requires that we comply with certain requirements that may affect our ability to pursue additional business opportunities. As of the date of this prospectus, we cannot determine the probability that during 2006 we will qualify as a RIC when we file our 2006 tax return.

Assuming we are successful in attaining and maintaining our RIC status, prior to the end of our first tax year as a RIC, we will be required to make a distribution to our stockholders equal to the amount of any earnings and profits from the period prior to our RIC election. Currently, we intend to retain some or all of our realized net long-term capital gains in order to build our per share net asset value. As a result, we will elect to make deemed distributions of such amounts to our stockholders. We may, in the future, make actual distributions to our stockholders of some or all of our realized net long-term capital gains. See Certain United States Federal Income Tax Considerations.

### **Dividend Reinvestment Plan**

We have adopted an opt-out dividend reinvestment plan through which distributions are paid to stockholders in the form of additional shares of our common stock, unless a stockholder elects to receive cash. See Dividend Reinvestment Plan. Those stockholders whose shares are held by a broker or other financial intermediary may receive distributions in cash by notifying their broker or other financial intermediary of their election.

### **Taxation**

From incorporation through December 31, 2005, we were taxed as a corporation under Subchapter C of the Internal Revenue Code of 1986, as amended, which we refer to in this prospectus as the Code. We currently intend to seek election to be treated for federal income tax purposes as a RIC under Subchapter M of the Code with the filing of our federal corporate income tax return for 2006, which election, when actually made, would be effective as of January 1, 2006. As a RIC, we generally will not pay corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders as dividends. We may be required, however, to pay corporate-level federal income taxes on gains built into our assets as of the effective date of our RIC election. See Certain United States Federal Income Tax Considerations Conversion to Regulated Investment Company Status. To obtain and maintain the federal income tax benefits of RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually an amount equal to at least 90% of the sum of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of assets legally available for distribution. See Distributions. There is no assurance that we will meet these tests and be eligible to make a RIC election. As of the date of this report we cannot determine the probability that during 2006 we will qualify as a RIC when we file our 2006 tax return. If we do not qualify or do not make a RIC election, we would continue to be taxed as a C corporation.

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### **Leverage**

We borrow funds to make additional investments, and we have granted, and may in the future grant, a security interest in our assets to a lender in connection with any such borrowings, including any borrowings by any of our subsidiaries. We use this practice, which is known as leverage, to attempt to increase returns to our common stockholders. However, leverage involves significant risks. See Risk Factors. With certain limited exceptions, we are only allowed to borrow amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after such borrowing. Our asset coverage as of December 31, 2005 was approximately 250%. The amount of leverage that we employ will depend on our assessment of market and other factors at the time of any proposed borrowing. As of February 28, 2006, we had outstanding \$25.0 million in aggregate principal amount of indebtedness under our bridge loan facility (\$10 million of which we subsequently repaid, see Recent Developments ) and \$61.0 million drawn under our securitization credit facility. See Obligations and Indebtedness. If our subsidiary is able to obtain a license under the Small Business Investment Act of 1958, we intend to borrow money from the Small Business Administration.

### **Recent Developments**

At December 31, 2005, we reduced the fair value of an investment in one portfolio company by approximately \$3.3 million to the expected realizable fair value of \$1.3 million. In January 2006, the principle assets of the portfolio company were sold, and we received a cash distribution of approximately \$1.3 million. On February 6, 2006, we received an additional contingent cash distribution of \$239,000 which will be accounted for as a loss recovery in the first quarter of 2006. Terms of the asset sale agreement call for two additional contingent payments of up to \$500,000 each from which we are contractually entitled to receive approximately \$350,000 each, but the conditions of the agreement make receipt and amount of payments uncertain and we will account for any future receipts as loss recoveries at the time of payment.

In December 2005, the Company declared a dividend of \$0.30 per share for shareholders of record on January 6, 2006. The dividend payment totaling approximately \$2.9 million was distributed to shareholders on January 27, 2006.

On March 6, 2006, we increased our Citibank credit facility from \$100 million to \$125 million. As of February 28, 2006, we had \$61.0 million outstanding under the Citibank credit facility.

On March 6, 2006, we entered into an agreement to repay \$10.0 million of the \$25.0 million outstanding under our loan with an affiliate of Farallon Capital. We extended the maturity of the remaining \$15.0 million from April 12, 2006 to June 30, 2006 and decreased the interest rate from 13.5% to 10.86%.

As of March 2, 2006, various funds affiliated with Farallon agreed to purchase \$5.0 million of our common stock at a price per share equal to our net asset value per share as of February 28, 2006. On March 20, 2006, we completed the sale of 432,900 shares of common stock to the Farallon funds at a price per share of \$11.55, which was the net asset value per share at February 28, 2006.

### **Principal Risk Factors**

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Investing in us involves certain risks relating to our structure and our investment objective that you should consider before deciding whether to invest. In addition, we expect that our portfolio will continue to consist primarily of securities issued by privately-held technology-related companies, which generally require additional capital to become profitable. These investments may involve a high degree of business and financial risk, and they are generally illiquid. Our portfolio companies typically will require additional outside capital beyond our investment in order to succeed or to fully repay the amounts owed to us. A large number of entities compete for the same kind of investment opportunities as we seek.

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We borrow funds to make our investments in portfolio companies. As a result, we are exposed to the risks of leverage, which may be considered a speculative investment technique. Borrowings magnify the potential for gain and loss on amounts invested and, therefore increase the risks associated with investing in our common stock. Also, we are subject to certain risks associated with valuing our portfolio, changing interest rates, accessing additional capital, fluctuating quarterly results, and operating in a regulated environment. See **Risk Factors** beginning on page 13 for a discussion of factors you should carefully consider before deciding whether to invest in our common stock.

### **Certain Anti-Takeover Provisions**

Our charter and bylaws, as well as certain statutes and regulations, contain provisions that may have the effect of discouraging a third party from making an acquisition proposal for our company. This could delay or prevent a transaction that could give our stockholders the opportunity to realize a premium over the price for their securities.

### **General Information**

Our principal executive offices are located at 525 University Avenue, Suite 700, Palo Alto, California 94301, and our telephone number is (650) 289-3060. We also have offices in Waltham, Massachusetts; Boston, Massachusetts; Boulder, Colorado; and the Chicago, Illinois area. We maintain a website on the Internet at [www.herculestech.com](http://www.herculestech.com). Information contained in our website is not incorporated by reference into this prospectus, and you should not consider that information to be part of this prospectus.

We file annual, quarterly and current periodic reports, proxy statements and other information with the SEC under the Securities Exchange Act of 1934, which we refer to as the Exchange Act. This information is available at the SEC's public reference room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information about the operation of the SEC's public reference room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet website, at [www.sec.gov](http://www.sec.gov), that contains reports, proxy and information statements, and other information regarding issuers, including us, who file documents electronically with the SEC.



**Table of Contents****FEES AND EXPENSES**

The following table is intended to assist you in understanding the various costs and expenses that an investor in our common stock or rights will bear directly or indirectly. However, we caution you that some of the percentages indicated in the table below are estimates and may vary. Except where the context suggests otherwise, whenever this prospectus contains a reference to fees or expenses paid by you or us or that we will pay fees or expenses, stockholders will indirectly bear such fees or expenses as investors in Hercules Technology Growth Capital.

<b>Stockholder Transaction Expenses (as a percentage of the public offer price):</b>	
Sales load	4.0% <sup>(1)</sup>
Dividend reinvestment plan fees	(2)
	4.0%
<b>Annual Expenses (as a percentage of average net assets attributable to common stock):<sup>(3)(4)</sup></b>	
Operating expenses	7.9% <sup>(5)(6)</sup>
Interest payments on borrowed funds	2.3% <sup>(7)</sup>
Fees paid in connection with borrowed funds	1.4% <sup>(8)</sup>
	11.6% <sup>(9)</sup>

- (1) We have agreed to pay the co-dealer managers a fee for their financial advisory, marketing and soliciting services equal to 4.0% of the aggregate subscription price for the shares issued pursuant to the offer. We have also agreed to reimburse the co-dealer managers an aggregate of up to \$75,000 for their expenses incurred in connection with the offer. See The Rights Offering Distribution Arrangements.
- (2) The expenses associated with the administration of our dividend reinvestment plan are included in Operating expenses. We pay all brokerage commissions incurred with respect to open market purchases, if any, made by the administrator under the plan. For more details about the plan, see Dividend Reinvestment Plan.
- (3) Average net assets attributable to common stock equals weighted average net assets for fiscal 2005, which was approximately \$79 million.
- (4) Net assets attributable to common stock was approximately \$114 million at December 31, 2005. Total annual expenses for fiscal 2005 as a percentage of net assets attributable to common stock as of December 31, 2005 would be 8.0%.
- (5) Operating expenses represent our annual operating expenses for fiscal 2005.
- (6) We do not have an investment adviser and are internally managed by our executive officers under the supervision of our Board of Directors. As a result, we do not pay investment advisory fees, but instead we pay the operating costs associated with employing investment management professionals.
- (7) Interest payments on borrowed funds represents interest payments on borrowed funds in fiscal 2005. The Company did not borrow funds until April 12, 2005 and therefore did not make interest payments prior to that date.
- (8) Fees paid in connection with borrowed funds represents fees paid in connection with borrowed funds in fiscal 2005. The Company did not borrow funds until April 12, 2005 and therefore did not incur fees in connection with the borrowed funds prior to that date.
- (9) Total annual expenses is the sum of operating expenses, interest payments on borrowed funds and fees paid in connection with borrowed funds.

**Example**

The following example demonstrates the projected dollar amount of total cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in our common stock. These amounts are based upon our payment of annual operating expenses at the levels set forth in the table above and assume no additional leverage.

<u>1 year</u>	<u>3 years</u>	<u>5 years</u>	<u>10 years</u>
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You would pay the following expenses on a \$1,000 investment, assuming a 5% annual return	\$ 147.77	\$ 343.11	\$ 514.29	\$ 855.26
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The example and the expenses in the tables above should not be considered a representation of our future expenses, and actual expenses may be greater or lesser than those shown. Moreover, while the example assumes, as required by the applicable rules of the SEC, a 5% annual return, our performance will vary and may result in a return greater or lesser than 5%. In addition, while the example assumes reinvestment of all dividends and distributions at net asset value, participants in our dividend reinvestment plan may receive shares valued at the market price in effect at that time. This price may be at, above or below net asset value. See [Dividend Reinvestment Plan](#) for additional information regarding our dividend reinvestment plan.

**Table of Contents****SELECTED CONSOLIDATED FINANCIAL DATA**

The following consolidated financial data is derived from our audited consolidated financial statements. The selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations on page 45 and the consolidated financial statements and related notes included elsewhere herein. The historical data are not necessarily indicative of results to be expected for any future period.

	Year ended December 31, 2005 <sup>(1)</sup>	Period from February 2, 2004 to December 31, 2004 <sup>(1)</sup>
<b>Statement of Operations Data:</b>		
Investment Income:		
Interest	\$ 9,791,214	\$ 214,100
Fees	875,429	
Total investment income	10,666,643	214,100
Operating expenses:		
Interest	1,800,536	
Loan fees	1,098,507	
Compensation and benefits	3,705,784	1,164,504
General and administrative	2,285,038	411,418
Stock-based compensation <sup>(2)</sup>	252,000	680,000
Total operating expenses	9,141,865	2,255,922
Net investment income (loss) before provision for income tax expense and investment gains and losses	1,524,778	(2,041,822)
Income tax expense	(255,000)	
Net investment income (loss)	1,269,778	(2,041,822)
Net realized gain on equity investment	481,694	
Net increase in unrealized appreciation on investments	353,093	
Net gain on investments	834,787	
Net increase (decrease) in net assets resulting from operations	\$ 2,104,565	\$ (2,041,822)
	As of	As of
	December 31, 2005	December 31, 2004
<b>Balance Sheet Data:</b>		
Investments, at value	\$ 176,673,226	\$ 16,700,000
Cash and cash equivalents	15,362,447	8,678,329
Total assets	193,647,879	25,232,672
Total liabilities <sup>(3)</sup>	79,295,549	154,539

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Total net assets	\$	114,352,330	\$	25,078,133
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**Other Data:**

Total debt investments, at value	\$	171,805,963	\$	16,700,000
Total equity investments, at value		4,867,263		
Unfunded commitments		30,200,000		5,000,000
Net asset value per share <sup>(4)</sup>	\$	11.67	\$	12.18

(1) We commenced operations on February 2, 2004 but did not commence investment operations until September 2004 and as a result, there is no period with which to compare our results of operations for the year ended December 31, 2005 or the period from February 2, 2004 to December 31, 2004.

(2) Non-cash expense under FAS 123R relates to options and warrants granted to employees.

(3) See the Senior Securities information on page 78.

(4) Based on common shares outstanding at period-end. At February 28, 2006, the net asset value per share was \$11.55.

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**RISK FACTORS**

*Investing in our common stock or the rights involves a high degree of risk. Before you invest in shares of our common stock or rights, you should be aware of various risks, including those described below. You should carefully consider these risks, together with all of the other information included in this prospectus, before you decide whether to make an investment in our common stock or rights. The risks set forth below are not the only risks we face. If any of the following risks occur, our business, financial condition and results of operations could be materially adversely affected. In such case, our net asset value and the trading price of our common stock and rights could decline, and you may lose all or part of your investment.*

**Risks Related to our Business and Structure**

*We have a limited operating history as a business development company, which may affect our ability to manage our business and may impair your ability to assess our prospects.*

We were incorporated in December 2003 and commenced investment operations in September 2004. We are subject to all of the business risks and uncertainties associated with any new business enterprise, including the risk that we will not achieve our investment objective and that the value of our common stock or rights could decline substantially. We have limited operating history as a business development company and have not yet been able to elect to be treated as a RIC for tax purposes. As a result, we have limited operating results under these regulatory frameworks that can demonstrate to you either their effect on the business or our ability to manage the business within these frameworks. See Regulation and Certain United States Federal Income Tax Considerations. If we fail to maintain our status as a business development company or fail to qualify as a RIC, our operating flexibility and results of operations would be significantly affected.

*We are dependent upon key management personnel for our future success, particularly Manuel A. Henriquez, and if we are not able to hire and retain qualified personnel, or if we lose any member of our senior management team, our ability to implement our business strategy could be significantly harmed.*

We depend upon the members of our senior management, particularly Mr. Henriquez, as well as other key personnel for the identification, final selection, structuring, closing and monitoring of our investments. These employees have critical industry experience and relationships on which we rely to implement our business plan. If we lose the services of Mr. Henriquez, or of any other senior management members, we may not be able to operate the business as we expect, and our ability to compete could be harmed, which could cause our operating results to suffer. We believe our future success will depend, in part, on our ability to identify, attract and retain sufficient numbers of highly skilled employees. If we do not succeed in identifying, attracting and retaining such personnel, we may not be able to operate our business as we expect.

*Our business model depends to a significant extent upon strong referral relationships with venture capital and private equity fund sponsors, and our inability to develop or maintain these relationships, or the failure of these relationships to generate investment opportunities, could adversely affect our business.*

We expect that members of our management team will maintain their relationships with venture capital and private equity firms, and we will rely to a significant extent upon these relationships to provide us with our deal flow. If we fail to maintain our existing relationships or to develop new relationships with other firms or sources of investment opportunities, then we will not be able to grow our investment portfolio. In

addition, persons with whom members of our management team have relationships are not obligated to provide us with investment opportunities and, therefore, there is no assurance that such relationships will lead to the origination of debt or other investments.

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***We operate in a highly competitive market for investment opportunities, and we may not be able to compete effectively.***

A large number of entities compete with us to make the types of investments that we plan to make in prospective portfolio companies. We compete with a large number of venture capital and private equity firms, as well as with other investment funds, investment banks and other sources of financing, including traditional financial services companies such as commercial banks and finance companies. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. For example, some competitors may have a lower cost of funds and/or access to funding sources that are not available to us. This may enable some competitors to make commercial loans with interest rates that are comparable to or lower than the rates that we typically offer. We may lose prospective portfolio companies if we do not match competitors' pricing, terms and structure. If we do match competitors' pricing, terms or structure, we may experience decreased net interest income and increased risk of credit losses. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments, establish more relationships and build their market shares. Furthermore, many potential competitors are not subject to the regulatory restrictions that the 1940 Act imposes on us as a business development company or that the Code would impose on us as a RIC. If we are not able to compete effectively, our business, financial condition, and results of operations will be adversely affected. As a result of this competition, there can be no assurance that we will be able to identify and take advantage of attractive investment opportunities that we identify, or that we will be able to fully invest our available capital.

***Because we intend to distribute substantially all of our income to our stockholders if we are treated as a RIC, we will continue to need additional capital to finance our growth. If additional funds are unavailable or not available on favorable terms, our ability to grow will be impaired.***

In order to satisfy the requirements applicable to a RIC, to avoid payment of excise taxes and to minimize or avoid payment of income taxes, we intend as a RIC to distribute to our stockholders substantially all of our ordinary income and realized net capital gains except for certain realized net long-term capital gains, which we currently intend to retain, pay applicable income taxes with respect thereto and elect to treat as deemed distributions to our stockholders. As a business development company, we generally are required to meet a coverage ratio of total assets to total borrowings and other senior securities, which includes all of our borrowings and any preferred stock that we may issue in the future, of at least 200%. This requirement limits the amount that we may borrow. Because we will continue to need capital to grow our loan and investment portfolio, this limitation may prevent us from incurring debt and require us to raise additional equity at a time when it may be disadvantageous to do so. While we expect to be able to borrow and to issue additional debt and equity securities, we cannot assure you that debt and equity financing will be available to us on favorable terms, or at all, and debt financings may be restricted by the terms of any of our outstanding borrowings. In addition, as a business development company, we generally are not permitted to issue equity securities priced below net asset value without stockholder approval and approval of our independent directors. If additional funds are not available to us, we could be forced to curtail or cease new lending and investment activities, and our net asset value could decline.

***Because we borrow money, there could be increased risk in investing in our company.***

Lenders have fixed dollar claims on our assets that are superior to the claims of stockholders, and we have granted, and may in the future grant, lenders a security interest in our assets in connection with borrowings. In the case of a liquidation event, those lenders would receive proceeds before our stockholders. In addition, borrowings, also known as leverage, magnify the potential for gain or loss on amounts invested and, therefore, increase the risks associated with investing in our securities. Leverage is generally considered a speculative investment technique. If the value of our assets increases, then leveraging would cause the net asset value attributable to our common stock to increase more than it otherwise would have had we not leveraged. Conversely, if the value of our assets decreases, leveraging would cause the net asset value attributable to our common stock to decline more than it otherwise would have had we not leveraged. Similarly, any increase in our





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revenue in excess of interest expense on our borrowed funds would cause our net income to increase more than it would without the leverage. Any decrease in our revenue would cause our net income to decline more than it would have had we not borrowed funds and could negatively affect our ability to make distributions on common stock. Our ability to service any debt that we incur will depend largely on our financial performance and will be subject to prevailing economic conditions and competitive pressures.

As of December 31, 2005, we had outstanding indebtedness of \$25 million pursuant to our bridge loan from an affiliate of Farallon Capital Management, L.L.C. On August 1, 2005, the Company, through Hercules Funding Trust I, an affiliated statutory trust, executed a \$100 million securitized credit facility with Citigroup Global Market Realty Corp., which we increased to \$125 million on March 6, 2006, and which we refer to as the Citigroup Facility. As of February 28, 2006, we had drawn \$61 million under the Citigroup Facility. We expect, in the future, to borrow from, and issue senior debt securities to, banks, insurance companies and other lenders, including additional borrowings pursuant to the Citigroup Facility. See *Obligations and Indebtedness Warehouse Facility*. In addition, we expect to continue to pursue financing from the Small Business Administration under its Small Business Investment Company program. See *Obligations and Indebtedness SBIC Financing and Regulation Small Business Administration Regulations*.

As a business development company, we generally are required to meet a coverage ratio of total assets to total borrowings and other senior securities, which include all of our borrowings and any preferred stock that we may issue in the future, of at least 200%. If this ratio declines below 200%, we may not be able to incur additional debt and may need to sell a portion of our investments to repay some debt when it is disadvantageous to do so, and we may not be able to make distributions.

*Illustration.* The following table illustrates the effect of leverage on returns from an investment in our common stock assuming various annual returns, net of expenses. The calculations in the table below are hypothetical and actual returns may be higher or lower than those appearing in the table below.

	Assumed Return on our Portfolio				
	(net of expenses)				
	-10%	-5%	0%	5%	10%
Corresponding return to stockholder <sup>(1)</sup>	-21.0%	-12.6%	-4.1%	4.4%	12.8%

- (1) Assumes \$193.6 million in total assets, \$76.0 million in debt outstanding, \$114.4 million in stockholders' equity, and an average cost of funds of 6.15%, which is the approximate cost of funds of the warehouse facility we entered into on August 1, 2005. Actual interest payments may be different.

***Because most of our investments typically are not in publicly-traded securities, there is uncertainty regarding the value of our investments, which could adversely affect the determination of our net asset value.***

We expect our investments to continue to consist primarily of securities issued by privately-held companies, the fair value of which is not readily determinable. In addition, we are not permitted to maintain a general reserve for anticipated loan losses. Instead, we are required by the 1940 Act to specifically value each investment and record an unrealized gain or loss for any asset that we believe has increased or decreased in value. We value these securities at fair value as determined in good faith by our Board of Directors, based on the recommendations of our Board of Directors' Valuation Committee. The Valuation Committee utilizes its best judgment in arriving at the fair value of these securities. However, the Board of Directors retains ultimate authority as to the appropriate valuation of each investment. Because such valuations are inherently uncertain and may be based on estimates, our determinations of fair value may differ materially from the values that would be assessed if a ready

market for these securities existed. Our net asset value could be adversely affected if our determinations regarding the fair value of our investments were materially higher than the values that we ultimately realize upon the disposal of such securities.

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*Regulations governing our operations as a business development company affect our ability to, and the manner in which, we raise additional capital, which may expose us to risks.*

Our business will require a substantial amount of capital. We may acquire additional capital from the issuance of senior securities, including borrowings, securitization transactions or other indebtedness, or the issuance of additional shares of our common stock. However, we may not be able to raise additional capital in the future on favorable terms or at all. We may issue debt securities, other evidences of indebtedness or preferred stock, and we may borrow money from banks or other financial institutions, which we refer to collectively as senior securities, up to the maximum amount permitted by the 1940 Act. The 1940 Act permits us to issue senior securities in amounts such that our asset coverage, as defined in the 1940 Act, equals at least 200% after each issuance of senior securities. Our ability to pay dividends or issue additional senior securities would be restricted if our asset coverage ratio were not at least 200%. If the value of our assets declines, we may be unable to satisfy this test. If that happens, we may be required to liquidate a portion of our investments and repay a portion of our indebtedness at a time when such sales may be disadvantageous. As a result of issuing senior securities, we would also be exposed to typical risks associated with leverage, including an increased risk of loss. If we issue preferred stock, the preferred stock would rank senior to common stock in our capital structure, preferred stockholders would have separate voting rights and might have rights, preferences, or privileges more favorable than those of our common stockholders and the issuance of preferred stock could have the effect of delaying, deferring, or preventing a transaction or a change of control that might involve a premium price for holders of our common stock or otherwise be in your best interest.

To the extent that we are constrained in our ability to issue debt or other senior securities, we will depend on issuances of common stock to finance operations. Other than in certain limited situations such as this rights offering, as a business development company, we are generally not able to issue our common stock at a price below net asset value without first obtaining required approvals from our stockholders and our independent directors. If we raise additional funds by issuing more common stock or senior securities convertible into, or exchangeable for, our common stock, then the percentage ownership of our stockholders at that time will decrease, and you might experience dilution. In addition to issuing securities to raise capital as described above, we anticipate that, in the future, we may securitize our loans to generate cash for funding new investments. An inability to successfully securitize our loan portfolio could limit our ability to grow our business and fully execute our business strategy.

*Our ability to invest in certain private and public companies may be limited in certain circumstances.*

As a business development company, we must not acquire any assets other than qualifying assets unless, at the time of and after giving effect to such acquisition, at least 70% of our total assets are qualifying assets. We expect that substantially all of our assets will be qualifying assets, although we may decide to make other investments that are not qualifying assets to the extent permitted by the 1940 Act.

Currently, if we acquire debt or equity securities from an issuer that has outstanding marginable securities at the time that we make an investment, these acquired assets cannot be treated as qualifying assets. This result is dictated by the definition of eligible portfolio company under the 1940 Act, which in part looks to whether a company has outstanding marginable securities. For a more detailed discussion of the definition of an eligible portfolio company and the marginable securities requirement, see the section entitled Regulation Qualifying Assets.

Amendments promulgated in 1998 by the Federal Reserve expanded the definition of a marginable security under the Federal Reserve's margin rules to include any non-equity security. Thus, any debt securities issued by any entity are marginable securities under the Federal Reserve's current margin rules. As a result, the staff of the SEC has raised the question to the business development company industry as to whether a private company that has outstanding debt securities would qualify as an eligible portfolio company under the 1940 Act.

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The SEC has issued proposed rules to correct the unintended consequence of the Federal Reserve's 1998 margin rule amendments of apparently limiting the investment opportunities of business development companies.

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In general, the SEC's proposed rules would define an eligible portfolio company as any company that does not have securities listed on a national securities exchange or association. We are currently in the process of reviewing the SEC's proposed rules and assessing their impact, to the extent that such proposed rules are subsequently approved by the SEC, on our investment activities.

Until the SEC or its staff has taken a final public position with respect to the issue discussed above, we will continue to monitor this issue closely, and we may be required to adjust our investment focus to comply with any future administrative position or action taken by the SEC.

*We may have difficulty paying our required distributions if we recognize income before or without receiving cash representing such income.*

In accordance with generally accepted accounting principles and tax requirements, we include in income certain amounts that we have not yet received in cash, such as contracted payment-in-kind interest, which represents contractual interest added to a loan balance and due at the end of such loan's term. In addition to the cash yields received on our loans, in some instances, certain loans may also include any of the following: end-of-term payments, exit fees, balloon payment fees or prepayment fees. The increases in loan balances as a result of contracted payment-in-kind arrangements are included in income for the period in which such payment-in-kind interest was received, which is often in advance of receiving cash payment, and are separately identified on our statements of cash flows. We also may be required to include in income certain other amounts that we will not receive in cash.

Any warrants that we receive in connection with our debt investments will generally be valued as part of the negotiation process with the particular portfolio company. As a result, a portion of the aggregate purchase price for the debt investments and warrants will be allocated to the warrants that we receive. This will generally result in an original issue discount for tax purposes, which we must recognize as ordinary income, increasing the amount that we are required to distribute to qualify for the federal income tax benefits applicable to RICs. Because these warrants would not produce distributable cash for us at the same time as we are required to make distributions in respect of the related original issue discount, we would need to obtain cash from other sources to satisfy such distribution requirements. If we are unable to obtain cash from other sources to satisfy such distribution requirements, we may fail to qualify for the federal income tax benefits allowable to RICs and, thus, become subject to a corporate-level income tax on all our income.

Other features of the debt instruments that we hold may also cause such instruments to generate an original issue discount, resulting in a dividend distribution requirement in excess of current cash interest received. Since in certain cases we may recognize income before or without receiving cash representing such income, we may have difficulty meeting the requirement to distribute at least 90% of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any. If we are unable to meet these distribution requirements, we will not qualify for the federal income tax benefits allowable to a RIC. Accordingly, we may have to sell some of our assets, raise additional debt or equity capital or reduce new investment originations to meet these distribution requirements. See "Certain United States Federal Income Tax Considerations - Taxation as a Regulated Investment Company."

*There is a risk that you may not receive distributions or that our distributions may not grow over time.*

We intend to make distributions on a quarterly basis to our stockholders. We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash distributions or year-to-year increases in cash distributions. In addition, due to the asset coverage test applicable to us as a business development company, we may be limited in our ability to make distributions.



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*If we are unable to manage our future growth effectively, we may be unable to achieve our investment objective, which could adversely affect our financial condition and results of operations and cause the value of your investment to decline.*

Our ability to achieve our investment objective will depend on our ability to sustain growth. Sustaining growth will depend, in turn, on our senior management team's ability to identify, evaluate, finance and invest in suitable companies that meet our investment criteria. Accomplishing this result on a cost-effective basis is largely a function of our marketing capabilities, our management of the investment process, our ability to provide efficient services and our access to financing sources on acceptable terms. Failure to manage our future growth effectively could have a material adverse effect on our business, financial condition and results of operations.

*Our quarterly and annual operating results are subject to fluctuation as a result of the nature of our business, and if we fail to achieve our investment objective, the net asset value of our common stock may decline.*

We could experience fluctuations in our quarterly and annual operating results due to a number of factors, some of which are beyond our control, including the interest rate payable on the debt securities that we acquire, the default rate on such securities, the level of our expenses, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we encounter competition in our markets and general economic conditions. As a result of these factors, results for any period should not be relied upon as being indicative of performance in future periods.

*Fluctuations in interest rates may adversely affect our profitability.*

A portion of our income will depend upon the difference between the rate at which we borrow funds and the interest rate on the debt securities in which we invest. Because we will borrow money to make investments, our net investment income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. Typically, we anticipate that our interest-earning investments will accrue and pay interest at fixed rates, and that our interest-bearing liabilities will accrue interest at variable rates. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income. We anticipate using a combination of equity and long-term and short-term borrowings to finance our investment activities.

A significant increase in market interest rates could harm our ability to attract new portfolio companies and originate new loans and investments. We expect that most of our initial investments in debt securities will be at fixed rates. However, in the event that we make investments in debt securities at variable rates, a significant increase in market interest rates could also result in an increase in our non-performing assets and a decrease in the value of our portfolio because our floating-rate loan portfolio companies may be unable to meet higher payment obligations. In periods of rising interest rates, our cost of funds would increase, resulting in a decrease in our net investment income. In addition, a decrease in interest rates may reduce net income, because new investments may be made at lower rates despite the increased demand for our capital that the decrease in interest rates may produce. We may, but will not be required to, hedge against the risk of adverse movement in interest rates in our short-term and long-term borrowings relative to our portfolio of assets. If we engage in hedging activities, it may limit our ability to participate in the benefits of lower interest rates with respect to the hedged portfolio. Adverse developments resulting from changes in interest rates or hedging transactions could have a material adverse effect on our business, financial condition, and results of operations.

*If we are unable to continue to borrow money in order to leverage our equity capital, then our ability to make new investments and to execute our business plan will be impaired.*

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As of February 28, 2006, we had borrowed \$25 million pursuant to our Bridge Loan Credit Facility and \$61 million pursuant to the Citigroup Facility.



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We expect to incur additional indebtedness if our subsidiary obtains a small business investment company license, from the Small Business Administration. There can be no assurance that we will be successful in obtaining any additional debt capital on terms acceptable to us or at all. If we are unable to obtain debt capital, then our equity investors will not benefit from the potential for increased returns on equity resulting from leverage to the extent that our investment strategy is successful.

*It is likely that the terms of any long-term or revolving credit or warehouse facility we may enter into in the future could constrain our ability to grow our business.*

On August 1, 2005, the Company, through Hercules Funding Trust I, an affiliated statutory trust, executed a \$100 million securitized credit facility with Citigroup. We expect to enter into additional revolving credit or warehouse facilities in the future. While there can be no assurance that we will be able to borrow from banks or other financial institutions, we expect that we will, at some time in the future, obtain a long-term or revolving credit facility or a warehouse facility. The current lenders have, and any future lender or lenders will have fixed dollar claims on our assets that are senior to the claims of our stockholders and, thus, will have a preference over our stockholders with respect to our assets. In addition, we may grant a security interest in our assets in connection with any such borrowing. We expect such a facility to contain customary default provisions such as a minimum net worth amount, a profitability test, and a restriction on changing our business and loan quality standards. An event of default under any credit facility would likely result, among other things, in termination of the availability of further funds under that facility and an accelerated maturity date for all amounts outstanding under the facility, which would likely disrupt our business and, potentially, the business of the portfolio companies whose loans that we financed through the facility. This could reduce our revenues and, by delaying any cash payment allowed to us under our facility until the lender has been paid in full, reduce our liquidity and cash flow and impair our ability to grow our business and maintain our status as a RIC.

*If we are unable to satisfy Code requirements for qualification as a RIC, then we will be subject to corporate-level income tax, which would adversely affect our results of operations and financial condition.*

We intend to seek to be treated as a RIC for federal income tax purposes with the filing of our federal corporate income tax return for 2006, which election when actually made, would be effective as of January 1, 2006. After we make this election, and if we qualify, to be treated as a RIC, we can generally avoid corporate-level federal income taxes on income distributed to our stockholders as dividends. As a RIC, we could be subject to tax on any unrealized net built-in gains in the assets held by us during the period in which we were not (or in which we failed to qualify as) a RIC that are recognized within the following 10 years, unless we make a special election to pay corporate-level tax on such built-in gain at the time of our RIC election or an exception applies. See *Certain United States Federal Income Tax Considerations Conversion to Regulated Investment Company Status*. We will not qualify for the tax treatment allowable to RICs if we are unable to comply with the source of income, diversification and distribution requirements contained in Subchapter M of the Code, or if we fail to maintain our election to be regulated as a business development company under the 1940 Act. If we fail to qualify for the federal income tax benefits allowable to RICs for any reason and remain or become subject to a corporate-level income tax, the resulting taxes could substantially reduce our net assets, the amount of income available for distribution to our stockholders and the actual amount of our distributions. Such a failure would have a material adverse effect on us, the net asset value of our common stock and the total return, if any, obtainable from your investment in our common stock. For additional information regarding our regulatory requirements, see *Regulation* and *Certain United States Federal Income Tax Considerations*. Any net operating losses that we incur in periods during which we qualify as a RIC will not offset net capital gains (i.e., net realized long-term capital gains in excess of net realized short-term capital losses) that we are otherwise required to distribute, and we cannot pass such net operating losses through to our stockholders. In addition, net operating losses that we carry over to a taxable year in which we qualify as a RIC normally cannot offset ordinary income or capital gains.

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*Changes in laws or regulations governing our business could negatively affect the profitability of our operations.*

Changes in the laws or regulations, or the interpretations of the laws and regulations, which govern business development companies, small business investment companies, RICs or non-depository commercial lenders could significantly affect our operations and our cost of doing business. We are subject to federal, state and local laws and regulations and are subject to judicial and administrative decisions that affect our operations, including our loan originations, maximum interest rates, fees and other charges, disclosures to portfolio companies, the terms of secured transactions, collection and foreclosure procedures, and other trade practices. If these laws, regulations or decisions change, or if we expand our business into jurisdictions that have adopted more stringent requirements than those in which we currently conduct business, then we may have to incur significant expenses in order to comply or we may have to restrict our operations. In addition, if we do not comply with applicable laws, regulations and decisions, then we may lose licenses needed for the conduct of our business and be subject to civil fines and criminal penalties, any of which could have a material adverse effect upon our business results of operations or financial condition.

*We are exposed to increased costs and risks associated with complying with regulations of corporate governance and disclosure standards.*

Section 404 of the Sarbanes-Oxley Act of 2002 requires management's annual review and evaluation of our internal control systems and attestations of the effectiveness of these systems by our independent auditors. We are commencing evaluation, documentation and testing of our internal control systems and procedures and considering improvements that may be necessary in order for us to comply with the requirements of Section 404 by the end of 2006. This process has required us to hire outside advisory services and will result in additional accounting and legal expenses. We may encounter problems or delays in completing the review and evaluation, the implementation of improvements and the receipt of a positive attestation by our independent auditors. While we believe that we currently have adequate internal controls over financial reporting, in the event that our chief executive officer, principal financial and accounting officer or independent auditors determine that our controls over financial reporting are not effective as defined under Section 404, investor perceptions of our company may be adversely affected and could cause a decline in the market price of our stock.

### **Risks Related to Our Investments**

*Our investments are concentrated in a limited number of technology-related companies, which subjects us to the risk of significant loss if any of these companies default on their obligations under any of their debt securities that we hold, or if any of the technology-related industry sectors experience a downturn.*

We have invested and intend to continue investing in a limited number of technology-related companies. A consequence of this limited number of investments is that the aggregate returns we realize may be significantly adversely affected if a small number of investments perform poorly or if we need to write down the value of any one investment. Beyond the asset diversification requirements to which we will be subject as a RIC, we do not have fixed guidelines for diversification or limitations on the size of our investments in any one portfolio company and our investments could be concentrated in relatively few issuers. In addition, we have invested in and intend to continue investing, under normal circumstances, at least 80% of the value of our total assets (including the amount of any borrowings for investment purposes) in technology-related and life-science companies. As a result, a downturn in technology-related and life-science industry sectors could materially adversely affect us.

*Our investments may be concentrated in emerging-growth or expansion-stage portfolio companies, which may have limited operating histories and financial resources.*

We expect that our portfolio will continue to consist primarily of investments in emerging-growth and expansion-stage privately-owned businesses, which may have relatively limited operating histories. Compared to

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larger established or publicly-owned firms, these companies may be particularly vulnerable to economic downturns, may have more limited access to capital and higher funding costs, may have a weaker financial position and may need more capital to expand or compete. These businesses also may experience substantial variations in operating results. They may face intense competition, including from companies with greater financial, technical and marketing resources. Furthermore, some of these companies do business in regulated industries and could be affected by changes in government regulation. Accordingly, these factors could impair their cash flow or result in other events, such as bankruptcy, which could limit their ability to repay their obligations to us, and may adversely affect the return on, or the recovery of, our investment in these companies.

***Our investment strategy focuses on technology-related and life-science companies, which are subject to many risks, including volatility, intense competition, shortened product life cycles and periodic downturns, and you could lose all or part of your investment.***

We have invested and will continue investing primarily in technology-related and life-science companies, many of which may have narrow product lines and small market shares, which tend to render them more vulnerable to competitors' actions and market conditions, as well as to general economic downturns. The revenues, income (or losses), and valuations of technology-related and life-science companies can and often do fluctuate suddenly and dramatically. In addition, technology-related markets are generally characterized by abrupt business cycles and intense competition. Beginning in mid-2000, there was substantial excess production capacity and a significant slowdown in many technology-related industries. This overcapacity, together with a cyclical economic downturn, resulted in substantial decreases in the market capitalization of many technology-related and life-science companies. While such valuations have recovered to some extent, such decreases in market capitalization may occur again, and any future decreases in technology-related and life-science company valuations may be substantial and may not be temporary in nature. Therefore, our portfolio companies may face considerably more risk of loss than do companies in other industry sectors.

Because of rapid technological change, the average selling prices of products and some services provided by technology-related and life-science companies have historically decreased over their productive lives. As a result, the average selling prices of products and services offered by technology-related and life-science companies may decrease over time, which could adversely affect their operating results, their ability to meet obligations under their debt securities and the value of their equity securities. This could, in turn, materially adversely affect our business, financial condition and results of operations.

***We have invested in and may continue investing in technology-related and life-science companies that do not have venture capital or private equity firms as equity investors, and these companies may entail a higher risk of loss than do companies with institutional equity investors, which could increase the risk of loss of your investment.***

Our portfolio companies will often require substantial additional equity financing to satisfy their continuing working capital and other cash requirements and, in most instances, to service the interest and principal payments on our investment. Portfolio companies that do not have venture capital or private equity investors may be unable to raise any additional capital to satisfy their obligations or to raise sufficient additional capital to reach the next stage of development. Portfolio companies that do not have venture capital or private equity investors may be less financially sophisticated and may not have access to independent members to serve on their boards, which means that they may be less successful than portfolio companies sponsored by venture capital or private equity firms. Accordingly, financing these types of companies may entail a higher risk of loss than would financing companies that are sponsored by venture capital or private equity firms.

***Economic recessions or downturns could impair the ability of our portfolio companies to repay loans, which, in turn, could increase our non-performing assets, decrease the value of our portfolio, reduce our volume of new loans and harm our operating results, which might have an adverse effect on our results of operations.***

Many of our portfolio companies may be susceptible to economic slowdowns or recessions and may be unable to repay our loans during such periods. Therefore, our non-performing assets are likely to increase and the

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value of our portfolio is likely to decrease during such periods. Adverse economic conditions also may decrease the value of collateral securing some of our loans and the value of our equity investments. Economic slowdowns or recessions could lead to financial losses in our portfolio and a decrease in revenues, net income and assets. Unfavorable economic conditions also could increase our funding costs, limit our access to the capital markets or result in a decision by lenders not to extend credit to us.

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of the portfolio company's loans and foreclosure on its secured assets, which could trigger cross-defaults under other agreements and jeopardize the portfolio company's ability to meet its obligations under the debt securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company. In addition, if a portfolio company goes bankrupt, even though we may have structured our investment as senior debt or secured debt, depending on the facts and circumstances, including the extent to which we actually provided significant managerial assistance, if any, to that portfolio company, a bankruptcy court might re-characterize our debt holding and subordinate all or a portion of our claim to that of other creditors. These events could harm our financial condition and operating results.

***The inability of our portfolio companies to commercialize their technologies or create or develop commercially viable products or businesses would have a negative impact on our investment returns.***

The possibility that our portfolio companies will not be able to commercialize their technology, products or business concepts presents significant risks to the value of our investment. Additionally, although some of our portfolio companies may already have a commercially successful product or product line when we invest, technology-related and life-science products and services often have a more limited market- or life-span than have products in other industries. Thus, the ultimate success of these companies often depends on their ability to continually innovate, or raise additional capital, in increasingly competitive markets. Their inability to do so could affect our investment return. In addition, the intellectual property held by our portfolio companies often represents a substantial portion of the collateral, if any, securing our investments. We cannot assure you that any of our portfolio companies will successfully acquire or develop any new technologies, or that the intellectual property the companies currently hold will remain viable. Even if our portfolio companies are able to develop commercially viable products, the market for new products and services is highly competitive and rapidly changing. Neither our portfolio companies nor we have any control over the pace of technology development. Commercial success is difficult to predict, and the marketing efforts of our portfolio companies may not be successful.

***An investment strategy focused primarily on privately-held companies presents certain challenges, including the lack of available information about these companies, a dependence on the talents and efforts of only a few key portfolio company personnel and a greater vulnerability to economic downturns.***

We invest primarily in privately-held companies. Generally, very little public information exists about these companies, and we are required to rely on the ability of our management team to obtain adequate information to evaluate the potential returns from investing in these companies. If we are unable to uncover all material information about these companies, then we may not make a fully informed investment decision, and we may lose money on our investments. Also, privately-held companies frequently have less diverse product lines and a smaller market presence than do larger competitors. Privately-held companies are, thus, generally more vulnerable to economic downturns and may experience more substantial variations in operating results than do larger competitors. These factors could affect our investment returns.

In addition, our success depends, in large part, upon the abilities of the key management personnel of our portfolio companies, who are responsible for the day-to-day operations of our portfolio companies. Competition for qualified personnel is intense at any stage of a company's development, and high turnover of personnel is common in technology-related companies. The loss of one or more key managers can hinder or delay a company's implementation of its business plan and harm its financial condition. Our portfolio companies may



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not be able to attract and retain qualified managers and personnel. Any inability to do so may negatively impact our investment returns.

*If our portfolio companies are unable to protect their intellectual property rights, then our business and prospects could be harmed. If our portfolio companies are required to devote significant resources to protecting their intellectual property rights, then the value of our investment could be reduced.*

Our future success and competitive position depend in part upon the ability of our portfolio companies to obtain and maintain proprietary technology used in their products and services, which will often represent a significant portion of the collateral, if any, securing our investment. The portfolio companies will rely, in part, on patent, trade secret and trademark law to protect that technology, but competitors may misappropriate their intellectual property, and disputes as to ownership of intellectual property may arise. Portfolio companies may, from time to time, be required to institute litigation in order to enforce their patents, copyrights or other intellectual property rights, to protect their trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement. Such litigation could result in substantial costs and diversion of resources. Similarly, if a portfolio company is found to infringe upon or misappropriate a third party's patent or other proprietary rights, that portfolio company could be required to pay damages to such third party, alter its own products or processes, obtain a license from the third party and/or cease activities utilizing such proprietary rights, including making or selling products utilizing such proprietary rights. Any of the foregoing events could negatively affect both the portfolio company's ability to service our debt investment and the value of any related debt and equity securities that we own, as well as any collateral securing our investment.

*Some of our portfolio companies may need additional capital, which may not be readily available.*

Our portfolio companies will often require substantial additional equity financing to satisfy their continuing working capital and other requirements, and in most instances to service the interest and principal payments on our investment. Each round of venture financing is typically intended to provide a company with only enough capital to reach the next stage of development. We cannot predict the circumstances or market conditions under which our portfolio companies will seek additional capital. It is possible that one or more of our portfolio companies will not be able to raise additional financing or may be able to do so only at a price or on terms unfavorable to us, either of which would negatively impact our investment returns. Some of these companies may be unable to obtain sufficient financing from private investors, public capital markets or traditional lenders. Accordingly, financing these types of companies may entail a higher risk of loss than would financing companies that are able to utilize traditional credit sources.

*If our investments do not meet our performance expectations, you may not receive distributions.*

We intend to make distributions on a quarterly basis to our stockholders. We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of these distributions from time to time. In addition, due to the asset coverage test applicable to us as a business development company, we may be limited in our ability to make distributions. See Regulation. Also, restrictions and provisions in any future credit facilities may limit our ability to make distributions. If and when we qualify to be treated as a RIC, if we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including failure to obtain, or possible loss of, the federal income tax benefits allowable to RICs. See Certain United States Federal Income Tax Considerations Taxation as a Regulated Investment Company. We cannot assure you that you will receive distributions at a particular level or at all.

*Any unrealized depreciation that we experience on our loan portfolio may be an indication of future realized losses, which could reduce our income available for distribution.*



As a business development company, we are required to carry our investments at market value or, if no market value is ascertainable, at the fair value as determined in good faith by our Board of Directors in

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accordance with procedures approved by our Board of Directors. Decreases in the market values or fair values of our investments will be recorded as unrealized depreciation. Any unrealized depreciation in our loan portfolio could be an indication of a portfolio company's inability to meet its repayment obligations to us with respect to the affected loans. This could result in realized losses in the future and ultimately in reductions of our income available for distribution in future periods.

*The lack of liquidity in our investments may adversely affect our business and, if we need to sell any of our investments, we may not be able to do so at a favorable price. As a result, we may suffer losses.*

We generally invest in debt securities with terms of up to seven years and hold such investments until maturity, and we do not expect that our related holdings of equity securities will provide us with liquidity opportunities in the near-term. We invest and expect to continue investing in companies whose securities are not publicly traded and whose securities are and will be subject to legal and other restrictions on resale or whose securities are and will be less liquid than are publicly-traded securities. The illiquidity of these investments may make it difficult for us to sell these investments when desired. In addition, if we are required to liquidate all or a portion of our portfolio quickly, we may realize significantly less than the value at which we had previously recorded these investments. As a result, we do not expect to achieve liquidity in our investments in the near-term. However, to maintain our qualification as a business development company and as a RIC, we may have to dispose of investments if we do not satisfy one or more of the applicable criteria under the respective regulatory frameworks. Our investments are usually subject to contractual or legal restrictions on resale, or are otherwise illiquid, because there is usually no established trading market for such investments. The illiquidity of most of our investments may make it difficult for us to dispose of the investments at a favorable price and, as a result, we may suffer losses.

*If the assets securing the loans that we make decrease in value, then we may lack sufficient collateral to cover losses.*

We believe that our portfolio companies generally will be able to repay our loans from their available capital, from future capital-raising transactions, or from cash flow from operations. However, to attempt to mitigate credit risks, we will typically take a security interest in the available assets of these portfolio companies, including the equity interests of their subsidiaries and, in some cases, the equity interests of our portfolio companies held by their stockholders. In many cases, our loans will include a period of interest-only payments. There is a risk that the collateral securing our loans may decrease in value over time, may be difficult to sell in a timely manner, may be difficult to appraise and may fluctuate in value based upon the success of the business and market conditions, including as a result of the inability of a portfolio company to raise additional capital. In some circumstances, our lien could be subordinated to claims of other creditors. Additionally, a deterioration in a portfolio company's financial condition and prospects, including its inability to raise additional capital, may be accompanied by a deterioration in the value of the collateral for the loan. Moreover, in the case of some of our structured mezzanine debt, we may not have a first lien position on the collateral. Consequently, the fact that a loan is secured does not guarantee that we will receive principal and interest payments according to the loan's terms, or that we will be able to collect on the loan should we be forced to enforce our remedies. In addition, because we invest in technology-related companies, a substantial portion of the assets securing our investment may be in the form of intellectual property, if any, inventory and equipment and, to a lesser extent, cash and accounts receivable. Intellectual property, if any, that is securing our loan could lose value if, among other things, the company's rights to the intellectual property are challenged or if the company's license to the intellectual property is revoked or expires. Inventory may not be adequate to secure our loan if our valuation of the inventory at the time that we made the loan was not accurate or if there is a reduction in the demand for the inventory. Similarly, any equipment securing our loan may not provide us with the anticipated security if there are changes in technology or advances in new equipment that render the particular equipment obsolete or of limited value, or if the company fails to adequately maintain or repair the equipment. Any one or more of the preceding factors could materially impair our ability to recover principal in a foreclosure.

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***Our portfolio companies may incur debt that ranks equally with, or senior to, our investments in such companies.***

We invest primarily in debt securities issued by our portfolio companies. In some cases portfolio companies will be permitted to have other debt that ranks equally with, or senior to, the debt securities in which we invest. Such debt instruments may provide that the holders thereof are entitled to receive payment of interest or principal on or before the dates on which we are entitled to receive payments in respect of the debt securities in which we invest. Also, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of debt instruments ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution in respect of our investment. After repaying such senior creditors, such portfolio company might not have any remaining assets to use for repaying its obligation to us. In the case of debt ranking equally with debt securities in which we invest, we would have to share on a pari passu basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy. In addition, we would not be in a position to control any portfolio company by investing in its debt securities. As a result, we are subject to the risk that a portfolio company in which we invest may make business decisions with which we disagree and the management of such companies, as representatives of the holders of their common equity, may take risks or otherwise act in ways that do not best serve our interests as debt investors.

***Our equity investments are highly speculative, and we may not realize gains from these investments. If our equity investments do not generate gains, then the return on our invested capital will be lower than it would otherwise be, which could result in a decline in the value of shares of our common stock.***

When we invest in debt securities, we generally expect to acquire warrants or other equity securities as well. Our goal is ultimately to dispose of these equity interests and realize gains upon disposition of such interests. Over time, the gains that we realize on these equity interests may offset, to some extent, losses that we experience on defaults under debt securities that we hold. However, the equity interests that we receive may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses that we experience.

***We do not control any of our portfolio companies and therefore our portfolio companies may make decisions with which we disagree.***

We do not control any of our portfolio companies, even though we may have board observation rights and our debt agreements may contain certain restrictive covenants. As a result, we are subject to the risk that a portfolio company in which we invest may make business decisions with which we disagree and the management of such company, as representatives of the holders of their common equity, may take risks or otherwise act in ways that do not serve our interests as debt investors.

***Prepayments of our debt investments by our portfolio companies could adversely impact our results of operations and reduce our return on equity.***

We are subject to the risk that the investments we make in our portfolio companies may be repaid prior to maturity. When this occurs, we will generally reinvest these proceeds in temporary investments, pending their future investment in new portfolio companies. These temporary investments will typically have substantially lower yields than the debt being prepaid and we could experience significant delays in reinvesting these amounts. Any future investment in a new portfolio company may also be at lower yields than the debt that was repaid. As a result, our results of operations could be materially adversely affected if one or more of our portfolio companies elects to prepay amounts owed to us. Additionally, prepayments could negatively impact our return on equity, which could result in a decline in the market price of our common stock.



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*We may not realize gains from our equity investments.*

When we invest in debt securities, we generally expect to acquire warrants or other equity securities as well. However, the equity interests we receive may not appreciate in value and, in fact, may decline in value. Accordingly, we may not be able to realize gains from our equity interests, and any gains that we do realize on the disposition of any equity interests may not be sufficient to offset any other losses we experience.

## **Risks Related to this Offering**

*Our common stock price may be volatile and may decrease substantially.*

The trading price of our common stock and rights following this offer may fluctuate substantially. The price of the common stock and rights that will prevail in the market after this offer may be higher or lower than the price you paid and the liquidity of our common stock may be limited, in each case depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include, but are not limited to, the following:

price and volume fluctuations in the overall stock market from time to time;

significant volatility in the market price and trading volume of securities of RICs, business development companies or other financial services companies;

any inability to deploy or invest our capital;

fluctuations in interest rates;

any shortfall in revenue or net income or any increase in losses from levels expected by investors or securities analysts;

operating performance of companies comparable to us;

changes in regulatory policies or tax guidelines with respect to RICs or business development companies;

our not electing or losing RIC status;

actual or anticipated changes in our earnings or fluctuations in our operating results, or changes in the expectations of securities analysts;

changes in the value of our portfolio of investments;

realized losses in investments in our portfolio companies;

general economic conditions and trends;

loss of a major funding source; or

departures of key personnel.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. Due to the potential volatility of our stock price, we may be the target of securities litigation in the future. Securities litigation could result in substantial costs and could divert management's attention and resources from our business.

***Investing in shares of our common stock or rights may involve an above average degree of risk.***

The investments we make in accordance with our investment objective may result in a higher amount of risk, volatility or loss of principal than alternative investment options. Our investments in portfolio companies may be highly speculative and aggressive, and therefore, an investment in our common stock, warrants, and warrants shares may not be suitable for investors with lower risk tolerance.

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*We cannot assure you that the market price of our common stock will not decline following the offer.*

We cannot predict the price at which our common stock or rights will trade. Shares of closed-end investment companies have in the past frequently traded at discounts to their net asset values and our stock may also be discounted in the market. This characteristic of closed-end investment companies is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether shares of our common stock or rights will trade above, at or below our net asset value. The risk of loss associated with this characteristic of closed-end investment companies may be greater for investors expecting to sell shares of common stock purchased in this offer soon after the offer. In addition, if our common stock trades below its net asset value, we will generally not be able to issue additional shares of our common stock at its market price without first obtaining the approval for such issuance from our stockholders and our independent directors.

*Provisions of the Maryland General Corporation Law, and of our charter and bylaws, could deter takeover attempts and have an adverse impact on the price of our common stock or rights.*

The Maryland General Corporation Law and our charter and bylaws contain provisions that may have the effect of discouraging, delaying, or making difficult a change in control of our company or the removal of our incumbent directors. We will be covered by the Business Combination Act of the Maryland General Corporation Law to the extent that such statute is not superseded by applicable requirements of the 1940 Act. However, our Board of Directors has adopted a resolution exempting from the Business Combination Act any business combination between us and any person to the extent that such business combination receives the prior approval of our board, including a majority of our directors who are not interested persons as defined in the 1940 Act. Our Board of Directors has already adopted a resolution exempting from the Business Combination Act any business combination between us and certain investment funds managed by JMP Asset Management, LLC and certain investment funds managed by Farallon Capital Management, L.L.C., and we have agreed with such investment funds that we will not alter or repeal such board resolution prior to the date that is two years after such investment funds cease to own at least 10% of our outstanding common stock in a manner that would make the Business Combination Act applicable to acquisitions of our stock by such investment funds without the written consent of such investment funds. In addition, our bylaws contain a provision exempting from the Control Share Acquisition Act any and all acquisitions by any person of shares of our stock. We have agreed with certain investment funds managed by JMP Asset Management, LLC and certain investment funds managed by Farallon Capital Management, L.L.C. that we will not repeal or amend such provision of our bylaws in a manner that would make the Control Share Acquisition Act applicable to acquisitions of our stock by such investment funds without the written consent of such investment funds prior to the date that is two years after such investment funds cease to own at least 10% of our outstanding common stock. If the applicable board resolution is repealed following such period of time or if our board does not otherwise approve a business combination, the Business Combination Act and the Control Share Acquisition Act (if we amend our bylaws to be subject to that Act) may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Under our charter, our Board of Directors is divided into three classes serving staggered terms, which will make it more difficult for a hostile bidder to acquire control of us. In addition, our Board of Directors may, without stockholder action, authorize the issuance of shares of stock in one or more classes or series, including preferred stock. See Description of Capital Stock. Subject to compliance with the 1940 Act, our Board of Directors may, without stockholder action, amend our charter to increase the number of shares of stock of any class or series that we have authority to issue. The existence of these provisions, among others, may have a negative impact on the price of our common stock and rights and may discourage third party bids for ownership of our company. These provisions may prevent any premiums being offered to you for shares of our common stock or rights.

*There is no established trading market for the rights, which could make it more difficult for you to sell rights and could adversely affect their price.*

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There can be no assurances that an active public market for the rights will develop as a result of the offer of the rights by any selling holder or that, if such a market develops, it will be maintained. We have applied for the



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rights to be quoted on the Nasdaq National Market under the symbol HTGCR. Future trading prices of the rights will depend on many factors, including the company's operating results, the market for similar securities and the performance of the company's common stock.

### ***Your interest in us may be diluted.***

Stockholders who do not fully exercise their rights should expect that they will, at the completion of the offer, own a smaller proportional interest in us than would otherwise be the case if they fully exercised their rights. We cannot state precisely the amount of any such dilution in share ownership because we do not know at this time what proportion of the shares will be purchased as a result of the offer.

In addition, if the subscription price is less than our net asset value per share, then our stockholders would experience an immediate dilution of the aggregate net asset value of their shares as a result of the offer. The amount of any decrease in net asset value is not predictable because it is not known at this time what the subscription price and net asset value per share will be on the expiration date of the offer or what proportion of the shares will be purchased as a result of the offer. Such dilution could be substantial.

The fact that the rights are transferable may reduce the effects of any dilution as a result of the offer. Rights holders can transfer or sell their rights. The cash received from the sale of rights is partial compensation for any possible dilution. There can be no assurances, however, that a market for the rights will develop or the rights will have any value in that market.

### ***We will have broad discretion over the use of proceeds of this offer, to the extent it is successful.***

We will have significant flexibility in applying the proceeds of this offer. In addition to making investments in our portfolio companies, we may also use the proceeds to pay operating expenses and repay outstanding debt and other expenses such as due diligence expenses of potential new investments. Our ability to achieve our investment objective may be limited to the extent that the net proceeds of the offer, pending full investment, are used to pay operating expenses. In addition, we can provide you no assurance that the current offer will be successful, or that by increasing the size of our available equity capital our expense ratio will be lowered.

### ***We are subject to market fluctuations in our stock price and investors could realize a loss as a result.***

As with any stock, the price of our shares will fluctuate with market conditions and other factors. If shares are sold, the price received may be more or less than the original investment. Whether investors will realize gains or losses upon the sale of our shares will not depend directly upon our net asset value, but will depend upon the market price of the shares at the time of sale. Since the market price of our shares will be affected by such factors as the relative demand for and supply of the shares in the market, general market and other economic conditions and other factors beyond our control, we cannot predict whether the shares will trade at, below or above our net asset value. Historically, our shares as well as those of other close-end investment companies, have frequently traded at a discount to their net asset value, which discount fluctuates over time.

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**FORWARD-LOOKING STATEMENTS; MARKET DATA**

The matters discussed in this prospectus, as well as in future oral and written statements by management of Hercules Technology Growth Capital, that are forward-looking statements are based on current management expectations that involve substantial risks and uncertainties which could cause actual results to differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements relate to future events or our future financial performance. We generally identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, could, intends, target, projects, contemplates, believes, estimates, pre the negative of these terms or other similar words. Important assumptions include our ability to originate new investments, achieve certain margins and levels of profitability, the availability of additional capital, and the ability to maintain certain debt to asset ratios. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this prospectus should not be regarded as a representation by us that our plans or objectives will be achieved. The forward-looking statements contained in this prospectus include statements as to:

our future operating results;

our business prospects and the prospects of our prospective portfolio companies;

the impact of investments that we expect to make;

our informal relationships with third parties;

the dependence of our future success on the general economy and its impact on the industries in which we invest;

the ability of our portfolio companies to achieve their objectives;

our expected financings and investments;

our regulatory structure and tax status;

our ability to operate as a business development company and a regulated investment company;

the adequacy of our cash resources and working capital; and

the timing of cash flows, if any, from the operations of our portfolio companies.

For a discussion of factors that could cause our actual results to differ from forward-looking statements contained in this prospectus, please see the discussion under Risk Factors. You should not place undue reliance on these forward-looking statements. The forward-looking statements made in this prospectus relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances occurring after the date of this prospectus.

This prospectus contains third-party estimates and data regarding valuations of venture capital-backed companies. These data were reported by Dow Jones, VentureOne, an independent venture capital industry research company which we refer to as VentureOne, in releases entitled "4Q '03 Venture Capital Investment Increases," dated January 26, 2004, "Venture-Backed Valuations Decline in 4Q '03," dated March 1, 2004, "Equity Financings for U.S. Venture-Backed Companies by Industry Group (1998-Q42004)," dated January 21, 2005, "Venture Capital Market Q4 '04" dated March 18, 2005 and "1Q '05 Financing Preview" dated April 25, 2005, along with attached data tables. VentureOne is commonly relied upon as an information source in the venture capital industry. Although we have not independently verified any such data, we believe that the industry information contained in such releases and data tables and included in this prospectus is reliable.

Certain industry estimates presented in this prospectus have been compiled by us from internally generated information and data, which, while believed by us to be reliable, have not been verified by any independent sources. These estimates are based on a number of assumptions, including increasing investment in venture capital and private equity-backed companies. Actual results may differ from projections and estimates, and this market may not grow at the rates projected, or at all. The failure of this market to grow at projected rates could have a material adverse effect on our business and the market price of our common stock and rights.

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**THE RIGHTS OFFERING**

**Purpose of the Offer**

Our Board of Directors has determined in good faith that the offer would result in a net benefit to the existing stockholders because it increases the equity capital available for making additional investments in technology-related and life sciences companies, and may also be available to pay operating expenses and the potential repayment of debt. The offer gives existing stockholders the right to purchase additional shares at a price that is expected to be below the then-current trading price without paying any commission or sales charges (although, if you exercise your rights through a financial institution, you are responsible for paying any fees which that institution may charge). The offer will increase the equity capital available for making additional investments. In order to continue to execute our investment objective, we must have sufficient liquidity to remain a credible source of capital to our portfolio companies and remain relevant in the market. At our currently anticipated pace of investment activity, and given our current capital commitments, we believe that we will have limited capital available for new investments in 2006 unless we increase our capital resources. In connection with the approval of this offer, our Board of Directors considered, among other things, the following factors:

the subscription price relative to the market price and to our net asset value per share;

the increased equity capital to be available upon completion of the offer for making additional investments consistent with our investment objective;

the ownership dilution to be experienced by partially or non-participating stockholders and possible net asset value dilution to be experienced by all stockholders;

the terms and expenses in connection with the offer relative to other alternatives for raising capital, including fees payable to the co-dealer managers;

the size of the offer in relation to the number of shares outstanding;

the market price of our common stock, both before and after the announcement of the offer; and

the general condition of the securities markets.

In determining that this offer is in our best interest and in the best interests of our stockholders, we have retained A.G. Edwards & Sons, Inc. and JMP Securities, the co-dealer managers for this offer, to provide us with financial advisory, marketing and soliciting services relating to this offer, including advice with respect to the structure, timing and terms of the offer. In this regard, our Board of Directors considered, among other things, using a fixed pricing versus a variable pricing mechanism, the benefits and drawbacks of conducting a non-transferable versus a transferable offer, the effect on us if this offer is not fully subscribed and the experience of the co-dealer managers in conducting offers.

We can provide no assurance that the current offer will be successful, or that by increasing the size of our available equity capital, our expense ratio will be lowered.

Although we have no present intention to do so, we may, in the future and in our discretion, choose to make additional offers from time to time for a number of shares and on terms which may or may not be similar to this offer. Any such future offer will be made in accordance with the 1940 Act.

#### **Terms of the Offer**

We are issuing to record date stockholders transferable rights to subscribe for up to approximately 3,420,000 shares of our common stock. Each record date stockholder is being issued one transferable right for each three shares of our common stock owned on the record date (1 for 3). The rights entitle each holder to acquire at the subscription price one share of our common stock for every right held, which we refer to as the

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basic subscription right. Rights may be exercised at any time during the subscription period, which commences on March 24, 2006, the record date, and ends at 5:00 p.m., New York City time, on April 13, 2006, the expiration date, unless extended by us.

The rights will be evidenced by subscription certificates which will be mailed to stockholders, except as discussed below under Foreign Stockholders. We will not issue fractional rights; we will round up the rights issued to you to the next whole right.

The rights are transferable, and we have been approved for quotation of the rights on the Nasdaq National Market under the symbol HTGCR. Rights holders who are not record date stockholders may purchase shares as described above, which we refer to as the basic subscription, and may be entitled to subscribe for shares pursuant to the over-subscription privilege (as described below). Rights holders who purchase shares in the basic subscription or pursuant to the over-subscription privilege are hereinafter referred to as participating rights holders.

Shares for which there is no subscription during the basic subscription will be offered, by means of the over-subscription privilege, first to record date stockholders who fully exercise the rights issued to them pursuant to this offer and who wish to acquire more than the number of shares they are entitled to purchase pursuant to the exercise of their rights. In addition, any non-record date rights holder who exercises rights is entitled to subscribe for remaining shares that are not otherwise subscribed for by record date stockholders. Shares acquired pursuant to the over-subscription privilege are subject to certain limitations and allocation. See Over-Subscription Privilege below.

For purposes of determining the number of shares a record date stockholder may acquire pursuant to the offer, broker-dealers, trust companies, banks or others whose shares are held of record by Cede & Co. ( Cede ) or by any other depository or nominee will be deemed to be the holders of the rights that are issued to Cede or the other depository or nominee on their behalf.

There is no minimum number of rights which must be exercised in order for the offer to close.

**Over-Subscription Privilege**

Shares not subscribed for by rights holders, which we refer to as remaining shares, will be offered, by means of the over-subscription privilege, first to record date stockholders who have fully exercised the rights issued to them and who wish to acquire more than the number of shares they are entitled to purchase pursuant to the basic subscription. Rights holders should indicate on the subscription certificate that they submit with respect to the exercise of the rights issued to them how many additional shares they are willing to acquire pursuant to the over-subscription privilege. If there are sufficient remaining shares, all record date stockholders' over-subscription requests will be honored in full. If record date stockholder requests for shares pursuant to the over-subscription privilege exceed the remaining shares available, the available remaining shares will be allocated pro-rata among stockholders who over-subscribe based on the number of shares held on the record date. The percentage of remaining shares each over-subscribing stockholder may acquire will be rounded down to result in delivery of whole shares. The allocation process may involve a series of allocations to assure that the total number of remaining shares available for over-subscriptions is distributed on a pro-rata basis. The formula to be used in allocating the available excess shares is as follows:

$$\frac{\text{Stockholder's Record Date Position}}{\text{Total Record Date Position of All Over-Subscribers}} \times \text{Excess Shares Remaining}$$

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Any rights holder other than record date stockholders who exercises rights is entitled to subscribe for remaining shares that are not otherwise over-subscribed for by record date stockholders. These non-record date

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rights holders should indicate, in the subscription certificate submitted with respect to the exercise of any rights, how many shares they are willing to acquire pursuant to the over-subscription privilege. There can be no assurance that non-record date rights holders will receive shares pursuant to the over-subscription privilege.

If sufficient remaining shares are available after the over-subscription privileges for the record date stockholders have been allotted, then all over-subscriptions by non-record date rights holders will be honored in full. If the remaining shares are insufficient to permit such allocation, the remaining shares will be allocated pro-rata among the non-record date rights holders who wish to exercise their over-subscription privilege, based on the number of rights held by such rights holders on the expiration date; provided, however, that if this pro-rata allocation results in any holder being allocated a greater number of shares than the holder subscribed for pursuant to the exercise of the over-subscription privilege, then such holder will be allocated only such number of shares pursuant to the over-subscription privilege as such holder subscribed for. The formula to be used in allocating the shares available to non-record date rights holders exercising their over-subscription privilege is as follows:

$$\frac{\text{Non-Record Date Rights Holder's Rights Ownership as of the Expiration Date}}{\text{Total Rights Ownership as of the Expiration Date of Non-Record Date Rights Holders Exercising Their Over-Subscription Privilege}} \times \text{Shares Available for Non-Record Date Rights Holders Exercising Their Over-Subscription Privilege}$$

Banks, brokers, trustees and other nominee holders of rights will be required to certify to the subscription agent, before any over-subscription privilege may be exercised with respect to any particular beneficial owner, as to the aggregate number of rights exercised pursuant to the basic subscription and the number of shares subscribed for pursuant to the over-subscription privilege by such beneficial owner.

We will not offer or sell in connection with the offer any shares that are not subscribed for pursuant to the basic subscription or the over-subscription privilege.

**The Subscription Price**

The subscription price for the shares to be issued pursuant to the offer will be 95% of the volume-weighted average of the sales prices of our shares of common stock on the Nasdaq National Market on the ten trading days ending on the date on which the offer expires. Since the expiration date will be April 13, 2006 (unless we extend the offer), and the subscription price will be determined on the expiration date, rights holders will not know the subscription price at the time of exercise and will be required initially to pay for both the shares subscribed for pursuant to their basic subscription rights and, if eligible, any additional shares subscribed for pursuant to the over-subscription privilege at the estimated subscription price of \$11.08 per share. Rights holders who exercise their rights will have no right to rescind a purchase after receipt of their completed subscription certificates together with payment for shares by the subscription agent. We do not have the right to withdraw the rights or cancel this offer after the rights have been distributed.

**Expiration of the Offer**



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The offer will expire at 5:00 p.m., New York City time, on April 13, 2006, unless extended by us. The rights will expire on the expiration date of the offer and may not be exercised thereafter.

Any extension of the offer will be followed as promptly as practicable by announcement thereof, and in no event later than 9:00 a.m., New York City time, on the next business day following the previously scheduled expiration date. Without limiting the manner in which we may choose to make such announcement, we will not, unless otherwise required by law, have any obligation to publish, advertise or otherwise communicate any such announcement other than by issuing a press release or such other means of announcement as we deem appropriate.

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**Dilutive Effects**

Any stockholder who chooses not to participate in this offer should expect to own a smaller interest in us upon completion of this offer. This offer will dilute the ownership interest and voting power of stockholders who do not fully exercise their basic subscription rights. The amount of dilution that a stockholder will experience could be substantial. Further, because the net proceeds per share from the offering may be lower than our net asset value per share, the offer may reduce our net asset value per share.

Shares of closed-end investment companies have in the past frequently traded at discounts to their net asset values. This characteristic of closed-end investment companies is separate and distinct from the risk that our net asset value per share may decline. We cannot predict whether our shares will trade above, at or below our net asset value.

The transferable feature of the rights will afford non-participating stockholders the potential of receiving cash payment upon the sale of rights, receipt of which may be viewed as partial compensation for the dilution of their interests.

**Notice of Net Asset Value Decline**

As required by the SEC's registration form, we will suspend the offer until we amend this prospectus if, subsequent to the effective date of this prospectus, our net asset value declines more than 10% from our net asset value as of that date. Accordingly, the expiration date would be extended and we would notify record date stockholders of the decline and permit participating rights holders to cancel their exercise of rights.

**Information Agent**

The Altman Group, which we call the information agent, will act as the information agent in connection with this offer. The Altman Group can be contacted at the below address:

The Altman Group

1200 Wall Street West 3rd Floor

Lyndhurst, NJ 07071

1-800-884-4590

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**Subscription Agent**

American Stock Transfer & Trust Company will act as the subscription agent in connection with this offer. The subscription agent will receive for its administrative, processing, invoicing and other services a fee estimated to be approximately \$5,000, plus reimbursement for all out-of-pocket expenses related to the offer.

Completed subscription certificates must be sent together with full payment of the subscription price for all shares subscribed for in the basic subscription and the pursuant to the over-subscription privilege to the subscription agent by one of the methods described below. Alternatively, an Eligible Guarantor Institution may send notices of guaranteed delivery by facsimile to 1-718-236-2641 which must be received by the subscription agent at or prior to 5:00 p.m., New York City time, on the expiration date of the offer. Facsimiles should be confirmed by telephone at 1-866-669-9888. We will accept only properly completed and duly executed subscription certificates actually received at any of the addresses listed below, at or prior to 5:00 p.m., New York City time, on the expiration date of the offer or by the close of business on the third business day after the expiration date of the offer following timely receipt of a notice of guaranteed delivery. See **Payment for Shares** below. In this prospectus, close of business means 5:00 p.m., New York City time, on the relevant date.

**Subscription Certificate Delivery Method**

**Address/Number**

By Notice of Guaranteed Delivery:

Contact an Eligible Guarantor Institution, which may include a commercial bank or trust company, a member firm of a domestic stock exchange or a savings bank or credit union, to notify us of your intent to exercise the rights.

By First Class Mail Only:

American Stock Transfer & Trust Company

(No Overnight/Express Mail)

Attn: Lou Tinto

P.O. Box 922, Wall Street Station,

New York, NY 10269-0560

1-866-669-9888.

By Hand to New York Delivery Window/or

American Stock Transfer & Trust Company

by Overnight Delivery:

ATTEN: REORGANIZATION DEPT.

59 Maiden Lane Plaza Level

New York, NY 10038

**Delivery to an address other than one of the addresses listed above will not constitute valid delivery.**

Any questions or requests for assistance concerning the method of subscribing for shares or for additional copies of this prospectus or subscription certificates or notices of guaranteed delivery may be directed to the subscription agent at its telephone number and address listed below:

**American Stock Transfer & Trust Company**

**Attn: Lou Tinto**

**P.O. Box 922, Wall Street Station,**

**New York, NY 10269-0560**

**1-866-669-9888**

Stockholders may also contact their broker-dealers or nominees for information with respect to the offer.

**Methods For Exercising Rights**

Rights are evidenced by subscription certificates that, except as described below under Foreign Stockholders, will be mailed to record date stockholders or, if a record date stockholder's shares are held by Cede or any other depository or nominee on their behalf, to Cede or such depository or nominee. Rights may be

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exercised by completing and signing the subscription certificate that accompanies this prospectus and mailing it in the envelope provided, or otherwise delivering the completed and duly executed subscription certificate to the subscription agent, together with payment in full for the shares at the estimated subscription price by the expiration date of the offer. Rights may also be exercised by contacting your broker, trustee or other nominee, who can arrange, on your behalf, to guarantee delivery of payment and delivery of a properly completed and duly executed subscription certificate pursuant to a notice of guaranteed delivery by the close of business on the third business day after the expiration date. A fee may be charged for this service. Completed subscription certificates and related payments must be received by the subscription agent prior to 5:00 p.m., New York City time, on or before the expiration date (unless payment is effected by means of a notice of guaranteed delivery as described below under "Payment for Shares") at the offices of the subscription agent at the address set forth above.

## **Exercise Of The Over-Subscription Privilege**

Record date stockholders who fully exercise all rights issued to them and rights holders other than record date stockholders, may both participate in the over-subscription privilege by indicating on their subscription certificate the number of shares they are willing to acquire. If sufficient remaining shares are available after the initial subscription, all over-subscriptions will be honored in full; otherwise remaining shares will be allocated first to record date stockholders and then (if any remaining shares are still available) to non-record date rights holders, and the number of remaining shares issued to some or all exercising rights holders participating in the over-subscription privilege may be reduced as described under "Over-Subscription Privilege" above.

## **Record Date Stockholders Whose Shares are Held by a Nominee**

Record date stockholders whose shares are held by a nominee, such as a bank, broker-dealer or trustee, must contact that nominee to exercise their rights. In that case, the nominee will complete the subscription certificate on behalf of the record date stockholder and arrange for proper payment by one of the methods set forth under "Payment for Shares" below.

## **Nominees**

Nominees, such as brokers, trustees or depositories for securities, who hold shares for the account of others should notify the respective beneficial owners of the shares as soon as possible to ascertain the beneficial owners' intentions and to obtain instructions with respect to the rights. If the beneficial owner so instructs, the nominee should complete the subscription certificate and submit it to the subscription agent with the proper payment as described under "Payment for Shares" below.

All questions as to the validity, form, eligibility (including times of receipt and matters pertaining to beneficial ownership) and the acceptance of subscription forms and the subscription price will be determined by us, which determinations will be final and binding. No alternative, conditional or contingent subscriptions will be accepted. We reserve the right to reject any or all subscriptions not properly submitted or the acceptance of which would, in the opinion of our counsel, be unlawful.

## **Foreign Stockholders**

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Subscription certificates will not be mailed to foreign stockholders. Foreign stockholders will receive written notice of this offer. The subscription agent will hold the rights to which those subscription certificates relate for these stockholders' accounts until instructions are received to exercise the rights, subject to applicable law. If no instructions have been received by 5:00 p.m., New York City time, on April 10, 2006, three business days prior to the expiration date (or, if the offer is extended, on or before three business days prior to the extended expiration date), the subscription agent will transfer the rights of these stockholders to the co-dealer managers, who will either purchase the rights or use their best efforts to sell them. The net proceeds, if any, from sale of those rights will be remitted to these stockholders.

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### **Payment For Shares**

Participating rights holders may choose between the following methods of payment:

(1) A participating rights holder may send the subscription certificate together with payment for the shares acquired in the basic subscription and any additional shares subscribed for pursuant to the over-subscription privilege to the subscription agent based on the estimated subscription price of \$11.08. To be accepted, the payment, together with a properly completed and executed subscription certificate, must be received by the subscription agent at one of the subscription agent's offices set forth above, at or prior to 5:00 p.m., New York City time, on the expiration date.

(2) A participating rights holder may request a Eligible Guarantor Institution as that term is defined in Rule 17Ad-15 under the Securities Exchange Act of 1934, as amended, to send a notice of guaranteed delivery by facsimile or otherwise guaranteeing delivery of (i) payment of the full estimated subscription price of \$11.08 per share for the shares subscribed for in the basic subscription and any additional shares subscribed for pursuant to the over-subscription privilege and (ii) a properly completed and duly executed subscription certificate. The subscription agent will not honor a notice of guaranteed delivery unless a properly completed and duly executed subscription certificate and full payment for the shares is received by the subscription agent at or prior to 5:00 p.m., New York City time, on April 11, 2006 (or, if the offer is extended, by the close of business two business days prior to the extended expiration date).

**Participating rights holders will have no right to rescind their subscription after receipt of their payment for shares by the subscription agent, except as provided above under Notice of Net Asset Value Decline.**

All payments by a participating rights holder must be in U.S. dollars by money order or check or bank draft drawn on a bank or branch located in the United States and payable to Hercules Technology Growth Capital, Inc. The subscription agent will hold all funds received by it prior to the final payment date pending pro-rata and distribution of the shares.

**The method of delivery of subscription certificates and payment of the subscription price to us will be at the election and risk of the participating rights holders, but if sent by mail it is recommended that such certificates and payments be sent by registered mail, properly insured, with return receipt requested, and that a sufficient number of days be allowed to ensure delivery to the subscription agent and clearance of payment prior to 5:00 p.m., New York City time, on the expiration date or the date guaranteed payments are due under a notice of guaranteed delivery (as applicable). Because uncertified personal checks may take at least five business days to clear, you are strongly urged to pay, or arrange for payment, by means of certified or cashier's check or money order.**

On a date within five business days following the expiration date, the subscription agent will send to each participating rights holder (or, if rights are held by Cede or any other depository or nominee, to Cede or such other depository or nominee) a confirmation showing (i) the number of shares purchased pursuant to the basic subscription; (ii) the number of shares, if any, acquired pursuant to the over-subscription privilege; (iii) the per share and total purchase price for the shares; and (iv) any additional amount payable to us by the participating rights holder or any excess to be refunded by us to the participating rights holder, in each case based on the subscription price as determined on the expiration date. If any participating rights holder, if eligible, exercises his or her right to acquire shares pursuant to the over-subscription privilege, any excess payment which would otherwise be refunded to him or her will be applied by us toward payment for shares acquired pursuant to the exercise of the over-subscription privilege. Any additional payment required from a participating rights holder must be received by the subscription agent within ten business days after the confirmation date. Any excess payment to be refunded by us to a participating rights holder will be mailed by the subscription agent to the rights holder as promptly as practicable.





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**Whichever of the two methods described above is used, issuance of the shares purchased is subject to collection of checks and actual payment.** If a participating rights holder who subscribes for shares pursuant to the basic subscription or over-subscription privilege does not make payment of any amounts due by the expiration date, the date guaranteed payments are due under a notice of guaranteed delivery or within ten business days of the confirmation date, as applicable, the subscription agent reserves the right to take any or all of the following actions: (i) find other participating rights holders who wish to subscribe for such subscribed and unpaid for shares; (ii) apply any payment actually received by it from the participating rights holder toward the purchase of the greatest whole number of shares which could be acquired by such participating rights holder upon exercise of the basic subscription and/or the over-subscription privilege; and/or (iii) exercise any and all other rights or remedies to which it may be entitled, including, without limitation, the right to set off against payments actually received by it with respect to such subscribed for shares.

All questions concerning the timeliness, validity, form and eligibility of any exercise of rights will be determined by us, whose determinations will be final and binding. We, in our sole discretion, may waive any defect or irregularity, or permit a defect or irregularity to be corrected within such time as we may determine, or reject the purported exercise of any right. Subscriptions will not be deemed to have been received or accepted until all irregularities have been waived or cured within such time as we determine in our sole discretion. The subscription agent will not be under any duty to give notification of any defect or irregularity in connection with the submission of subscription certificates or incur any liability for failure to give such notification.

## **Sale of Rights**

### **The Rights are Transferable until the Day Immediately Preceding the Expiration Date**

The rights have been approved for quotation on the Nasdaq National Market under the symbol HTGCR. While the Company and the co-dealer managers will use their best efforts to ensure that an adequate trading market for the rights will exist, no assurance can be given that a market for the rights will develop. Trading in the rights on the Nasdaq National Market is expected to be conducted beginning on or about March 24, 2006, and continuing until and including April 12, 2006 (or if the offer is extended, until the day immediately prior to the extended expiration date). Rights holders are encouraged to contact their broker-dealer, bank, trustee or other nominees for more information about trading of the rights.

### **Sales through Subscription Agent and Co-Dealer Managers**

Stockholders who do not wish to exercise any or all of their rights may instruct the subscription agent to sell any rights they do not intend to exercise themselves through or to a dealer manager. Subscription certificates representing the rights to be sold through or to a dealer manager must be received by the subscription agent on or before April 11, 2006 (or if the offer is extended, until two business days prior to the extended expiration date). Upon the timely receipt by the subscription agent of appropriate instructions to sell rights, the subscription agent will ask the dealer managers either to purchase or to use their best efforts to complete the sale and the subscription agent will remit the proceeds of the sale to the selling stockholders. If the rights can be sold, sales of such rights will be deemed to have been effected at the weighted-average price received by the selling dealer manager on the day such rights are sold. The sale price of any rights sold to the dealer managers will be based upon the then current market price for the rights. The dealer managers will also attempt to sell all rights which remain unclaimed as a result of subscription certificates being returned by the postal authorities to the subscription agent as undeliverable as of the fourth business day prior to the expiration date of the offer. The subscription agent will hold the proceeds from those sales for the benefit of such non-claiming stockholders until such proceeds are either claimed or revert to the state pursuant to applicable state law. There can be no assurance that the dealer managers will purchase or be able to complete the sale of any such rights, and neither we nor the dealer managers have guaranteed any minimum sales price for the rights. If a stockholder does not utilize the services of the subscription agent and chooses to use another broker-dealer or other financial institution to sell rights, then the other broker-dealer or financial institution may charge a fee to sell the rights.



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### **Other Transfers**

The rights evidenced by a subscription certificate may be transferred in whole by endorsing the subscription certificate for transfer in accordance with the accompanying instructions. A portion of the rights evidenced by a single subscription certificate may be transferred by delivering to the subscription agent a subscription certificate properly endorsed for transfer, with instructions to register such portion of the rights evidenced thereby in the name of the transferee and to issue a new subscription certificate to the transferee evidencing such transferred rights. In such event, a new subscription certificate evidencing the balance of the rights, if any, will be issued to the stockholder or, if the stockholder so instructs, to an additional transferee. The signature on the subscription certificate must correspond to the name as written upon the face of the subscription certificate, without alteration or enlargement, or any change. A signature guarantee must be provided by an Eligible Guarantor Institution as that term is defined in Rule 17Ad-15 under the Securities Exchange Act of 1934, as amended, subject to the standards and procedures adopted by us.

Stockholders wishing to transfer all or a portion of their rights should allow at least five business days prior to the expiration date of the offer for (i) the transfer instructions to be received and processed by the subscription agent; (ii) a new subscription certificate to be issued and transmitted to the transferee or transferees with respect to transferred rights, and to the transferor with respect to retained rights, if any; and (iii) the rights evidenced by such new subscription certificate to be exercised or sold by the recipients thereof. Neither we nor the subscription agent nor the co-dealer managers shall have any liability to a transferee or transferor of rights if subscription certificates are not received in time for exercise prior to the expiration date of the offer or sale prior to the day immediately preceding the expiration date of the offer (or, if the offer is extended, the extended expiration date).

Except for the fees charged by the subscription agent and co-dealer managers, which will be paid by us, all commissions, fees and other expenses (including brokerage commissions and transfer taxes) incurred or charged in connection with the purchase, sale or exercise of rights will be for the account of the transferor of the rights, and none of those commissions, fees or expenses will be paid by us, the subscription agent or the co-dealer managers.

We anticipate that the rights will be eligible for transfer through, and that the exercise of the basic subscription and the over-subscription privilege may be effected through, the facilities of the Depository Trust Company or DTC. Holders of DTC exercised rights may exercise the over-subscription privilege in respect of such DTC exercised rights by properly completing and duly executing and delivering to the subscription agent, at or prior to 5:00 p.m., New York City time, on the expiration date of the offer, a nominee holder over-subscription certificate or a substantially similar form satisfactory to the subscription agent, together with payment of the estimated subscription price for the number of shares for which the over-subscription privilege is to be exercised.

### **Delivery of Stock Certificates**

Participants in our dividend reinvestment plan will have any shares that they acquire pursuant to the offer credited to their stockholder dividend reinvestment accounts in the plan. Stockholders whose shares are held of record by Cede or by any other depository or nominee on their behalf or their broker-dealers' behalf will have any shares that they acquire credited to the account of Cede or the other depository or nominee. With respect to all other stockholders, stock certificates for all shares acquired will be mailed after payment for all the shares subscribed for has cleared, which may take up to 15 calendar days from the date of receipt of the payment.

### **Federal Income Tax Considerations of the Offer**

For federal income tax purposes, neither the receipt nor the exercise of the rights by record date stockholders will result in taxable income to such stockholders, and no loss will be realized if the rights expire without exercise.

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A record date stockholder's basis in a right will be zero unless either (i) the fair market value of the right on the date of distribution is 15% or more of the fair market value of the shares with respect to which the right was distributed or (ii) the record date stockholder elects, in his or her federal income tax return for the taxable year in which the right is received, to allocate part of the basis of the shares to the right. If either of clauses (i) or (ii) is applicable, then if the right is exercised, the record date stockholder will allocate his or her basis in the shares with respect to which the right was distributed between the shares and the right in proportion to the fair market values of each on the date of distribution.

The holding period of a right received by a record date stockholder includes the holding period of the shares with regard to which the right is issued. If the right is exercised, the holding period of the shares acquired begins on the date the right is exercised.

If a right is sold, a gain or loss will be realized by the rights holder in an amount equal to the difference between the basis of the right sold and the amount realized on its disposition.

A record date stockholder's basis for determining gain or loss upon the sale of a share acquired upon the exercise of a right will be equal to the sum of the record date stockholder's basis in the right, if any, and the subscription price per share. A record date stockholder's gain or loss recognized upon a sale of a share acquired upon the exercise of a right will be a capital gain or loss (assuming the share was held as a capital asset at the time of sale) and will be a long-term capital gain or loss if the share is held for more than one year.

The foregoing is a general summary of the material United States federal income tax consequences of the offer under the provisions of the Code and Treasury regulations in effect as of the date of the prospectus that are generally applicable to record date stockholders who are United States persons within the meaning of the Code, and does not address any foreign, state or local tax consequences. The Code and Treasury regulations are subject to change or differing interpretations by legislative or administrative action, which may be retroactive. Participating rights holders should consult their tax advisors regarding specific questions as to foreign, federal, state or local taxes.

## **ERISA Considerations**

Stockholders who are employee benefit plans subject to the Employee Retirement Income Security Act of 1974, which we refer to as ERISA (including corporate savings and 401(k) plans), Keogh or H.R. 10 plans of self-employed individuals and individual retirement accounts should be aware that additional contributions of cash to a retirement plan (other than rollover contributions or trustee-to-trustee transfers from other retirement plans) in order to exercise rights would be treated as contributions to the retirement plan and, when taken together with contributions previously made, may result in, among other things, excise taxes for excess or nondeductible contributions. In the case of retirement plans qualified under Section 401(a) of the Code and certain other retirement plans, additional cash contributions could cause the maximum contribution limitations of Section 415 of the Code or other qualification rules to be violated. It may also be a reportable distribution and there may be other adverse tax and ERISA consequences if rights are sold or transferred by a retirement plan.

Retirement plans and other tax exempt entities, including governmental plans, should also be aware that if they borrow in order to finance their exercise of rights, they may become subject to the tax on unrelated business taxable income under Section 511 of the Code. If any portion of an individual retirement account is used as security for a loan, the portion so used is also treated as distributed to the IRA depositor.

ERISA contains fiduciary responsibility requirements, and ERISA and the Code contain prohibited transaction rules that may impact the exercise of rights. Due to the complexity of these rules and the penalties for noncompliance, retirement plans should consult with their counsel

and other advisers regarding the consequences of their exercise of rights under ERISA and the Code.

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**Distribution Arrangements**

A.G. Edwards & Sons, Inc. and JMP Securities, which are broker-dealers and members of the National Association of Securities Dealers, Inc., will act as co-dealer managers for this offer. Under the terms and subject to the conditions contained in the dealer management agreement, the co-dealer managers will provide financial advisory and marketing services in connection with this offer and will solicit the exercise of rights and participation in the over-subscription privilege. This offer is not contingent upon any number of rights being exercised. We have agreed to pay the co-dealer managers a fee for their financial advisory, marketing and soliciting services equal to 4.0% of the aggregate subscription price for shares issued pursuant to this offer.

In addition, we have agreed to reimburse the co-dealer managers an aggregate amount up to \$75,000 for their expenses incurred in connection with this offer. We have agreed to indemnify the co-dealer managers for, or contribute to losses arising out of, certain liabilities, including liabilities under the Securities Act of 1933. The dealer manager agreement also provides that the co-dealer managers will not be subject to any liability to us in rendering the services contemplated by the dealer manager agreement except for any act of bad faith, willful misfeasance, or gross negligence of the co-dealer managers or reckless disregard by the co-dealer managers of its obligations and duties under the dealer manager agreement.

Prior to the expiration of this offer, the co-dealer managers may independently offer for sale shares, including shares acquired through purchasing and exercising the rights, at prices it sets. Either co-dealer manager may realize profits or losses independent of any fees described in this prospectus.

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**USE OF PROCEEDS**

Assuming 3,420,000 shares of our common stock are sold at the estimated subscription price of \$11.08, the net proceeds of the offer are estimated to be \$35,802,856, after deducting dealer manager fees and other expenses related to this offer payable by us estimated at approximately \$2,090,744, including an aggregate of up to \$75,000 to be paid to the co-dealer managers for their expenses incurred in connection with the offer. We plan to use the net proceeds of this offer to fund investments in accordance with our investment objective and to pay our operating expenses. See Business General.

We estimate that it will take up to three to six months for us to substantially invest the net proceeds of this offer, depending on the availability of attractive opportunities and market conditions. However, we can offer no assurance that we will be able to achieve this goal.

Pending such uses and investments, we will invest the net proceeds primarily in cash, cash equivalents, U.S. government securities or high-quality debt securities maturing in one year or less from the time of investment.



**Table of Contents****PRICE RANGE OF COMMON STOCK AND DISTRIBUTIONS**

Our common stock is traded on the Nasdaq National Market under the symbol HTGC. We completed the initial public offer of our common stock in June 2005 at the price of \$13.00 per share. Prior to such date there was no public market for our common stock.

The following table sets forth the range of high and low closing prices of our common stock as reported on the Nasdaq National Market and the dividends declared by us for each fiscal quarter since our initial public offer. The stock quotations are interdealer quotations and do not include markups, markdowns or commissions.

	NAV <sup>(1)</sup>	Price Range		Premium/ Discount of High Sales Price to NAV	Premium/ Discount of Low Sales Price to NAV	Cash Dividend Per Share <sup>(2)</sup>
		High	Low			
<b>2005</b>						
Second quarter (June 9, 2005 through June 30, 2005)	\$ 11.55	\$ 13.19	\$ 12.45	114.2%	107.8%	
Third quarter	\$ 11.71	\$ 14.41	\$ 11.90	123.1%	101.6%	\$ 0.025
Fourth quarter	\$ 11.67	\$ 12.68	\$ 9.71	108.7%	83.2%	\$ 0.300
<b>2006</b>						
First quarter (through March 23, 2006)	*	\$ 11.99	\$ 10.50	*	*	

(1) Net asset value per share is generally determined as of the last day in the relevant quarter and therefore may not reflect the net asset value per share on the date of the high and low sales prices. The net asset values shown are based on outstanding shares at the end of each period.

(2) Represents the dividend declared in the specified quarter.

\* Net asset value has not yet been calculated for this period.

The last reported price for our common stock on March 23, 2006 was \$11.33 per share. As of February 10, 2005, we had 1,237 stockholders of record.

Shares of business development companies may trade at a market price that is less than the value of the net assets attributable to those shares. The possibility that our shares of common stock will trade at a discount from net asset value or at premiums that are unsustainable over the long term are separate and distinct from the risk that our net asset value will decrease. At times, our shares of common stock have traded at a premium to net asset value and at times our shares of common stock have traded at a discount to the net assets attributable to those shares. It is not possible to predict whether the shares offered hereby will trade at, above, or below net asset value.

If we qualify and elect to be a RIC, we intend to distribute quarterly dividends to our stockholders following the effective date of such election. In order to avoid certain excise taxes imposed on RICs, we currently intend to distribute during each calendar year an amount at least equal to the sum of (1) 98% of our ordinary income for the calendar year, (2) 98% of our capital gains in excess of capital losses for the one year period ending on October 31 of the calendar year, and (3) any ordinary income and net capital gains for the preceding year that were not distributed during such year. We will not be subject to excise taxes on amounts on which we are required to pay corporate income tax (such as retained net capital gains). In order to obtain the tax benefits applicable to RICs, we will be required to distribute to our stockholders with respect to each taxable year at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses. We currently intend to retain for investment realized net long-term capital gains in excess of realized net short-term capital losses. We generally intend to make deemed distributions to our stockholders of any retained net capital gains. If this happens, you will be treated as if you received

an actual distribution of the capital gains we retain and then reinvested the net after-tax proceeds in our common stock. You also may be eligible to claim

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a tax credit (or, in certain circumstances, a tax refund) equal to your allocable share of the tax we paid on the capital gains deemed distributed to you. Please refer to [Certain United States Federal Income Tax Considerations](#) for further information regarding the consequences of our retention of net capital gains. We may, in the future, make actual distributions to our stockholders of some or all realized net long-term capital gains in excess of realized net short-term capital losses. We can offer no assurance that we will achieve results that will permit the payment of any cash distributions and, if we issue senior securities, we will be prohibited from making distributions if doing so causes us to fail to maintain the asset coverage ratios stipulated by the 1940 Act or if distributions are limited by the terms of any of our borrowings. See [Regulation](#).

We maintain an [opt-out dividend reinvestment plan](#) for our common stockholders. As a result, if we declare a dividend, cash dividends will be automatically reinvested in additional shares of our common stock unless the stockholder specifically [opts out](#) of the dividend reinvestment plan and chooses to receive cash dividends. See [Dividend Reinvestment Plan](#).

Our ability to make distributions will be limited by the asset coverage requirements under the 1940 Act. For a more detailed discussion, see [Regulation](#).

**Table of Contents****CAPITALIZATION**

The following table sets forth our capitalization as of December 31, 2005:

on an actual basis;

on an as adjusted basis to reflect the amendment of our bridge loan credit facility with Alcmene Funding, L.L.C. and the purchase by affiliates of Farallon Capital Management of 432,900 shares of common stock; and

on an as adjusted basis to reflect our sale of 3,420,000 shares of common stock at an estimated subscription price of \$11.08 per share after deducting the fee paid to the co-dealer managers and the estimated offering expenses payable by us.

This table should be read together with Use of Proceeds, Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes included elsewhere in this prospectus.

	as of December 31, 2005		
	Actual	As Adjusted to Reflect Amendment of Credit Facility and sale of Common Stock to Affiliate	As Adjusted to Reflect Sale of Common Stock
	(in thousands)		
Cash and cash equivalents	\$ 15,362	\$ 10,362	\$ 46,165
Borrowings	76,000	66,000	66,000
<b>Stockholders' Equity:</b>			
Common stock, par value \$0.001 per share; 30,000,000 shares authorized; 9,801,965 shares issued and outstanding, actual; 10,234,865 shares issued and outstanding, as adjusted for sale of common stock to our affiliate and 13,654,865 shares issued and outstanding, as adjusted to reflect sale of common stock	10	10	14
Additional paid-in capital	114,525	119,525	155,324
Distributable earnings (accumulated deficit)	(182)	(182)	(182)
Total stockholders' equity	114,353	119,353	155,156
Total capitalization	\$ 190,353	\$ 185,353	\$ 221,156

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion should be read in conjunction with our consolidated financial statements and related notes and other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this report contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to the factors discussed under Risk Factors, Forward-Looking Statements; Market Data appearing elsewhere herein.*

**Overview**

We are a specialty finance company that provides debt and equity growth capital to technology-related companies at all stages of development. We primarily finance privately-held companies backed by leading venture capital and private equity firms and also may finance certain publicly-traded companies. We originate our investments through our principal office located in Silicon Valley, as well as our additional offices in the Boston, Boulder and Chicago areas. Our goal is to be the leading structured mezzanine capital provider of choice for venture capital and private equity backed technology-related companies requiring sophisticated and customized financing solutions. We invest primarily in structured mezzanine debt and, to a lesser extent, in senior debt and equity investments. We use the term structured mezzanine debt investment to refer to any debt investment, such as a senior or subordinated secured loan, that is coupled with an equity component, including warrants, options or rights to purchase common or preferred stock. Our structured mezzanine debt investments will typically be secured by some or all of the assets of the portfolio company.

We are an internally managed, non-diversified closed-end investment company that has elected to be regulated as a business development company under the 1940 Act. As a business development company, we are required to comply with certain regulatory requirements. For instance, we generally have to invest at least 70% of our total assets in qualifying assets, including securities of private U.S. companies, cash, cash equivalents, U.S. government securities and high-quality debt investments that mature in one year or less.

From incorporation through December 31, 2005, we were taxed as a corporation under Subchapter C of the Code. We intend to seek to be treated for federal income tax purposes as a RIC under Subchapter M of the Code as of January 1, 2006. To qualify for the benefits allowable to a RIC, we must, among other things, meet certain source-of-income and asset diversification and income distribution requirements. Pursuant to this election, we generally will not have to pay corporate-level taxes on any income that we distribute to our stockholders. However, such an election and qualification to be treated as a RIC requires that we comply with certain requirements contained in Subchapter M of the Code that may affect our ability to pursue additional business opportunities or strategies which, if we were to determine we should pursue such strategies, may diminish the desirability of or impede our ability to qualify as a RIC. For example, a RIC must meet certain requirements, including source-of-income, asset diversification and income distribution requirements. The income source requirement mandates that we receive 90% or more of our income from qualified earnings, typically referred to as good income. Qualified earnings may exclude such income as management fees received in connection with our SBIC or other potential outside managed funds and certain other fees. As of the date of this report, we cannot determine the probability that during 2006 we will qualify as RIC when we file our 2006 federal tax return. See Certain United States Federal Tax Considerations Taxation as a Regulated Investment Company.

**Portfolio and Investment Activity**

## Edgar Filing: HERCULES TECHNOLOGY GROWTH CAPITAL INC - Form N-2/A

We commenced investment operations in September 2004 and entered into our first debt investment in November 2004. The total value of our investment portfolio was \$176.7 million at December 31, 2005 as compared to \$16.7 million at December 31, 2004. The increase in investments was due to newly originated debt and equity investments in 2005. During 2005, we made debt investments in 28 new portfolio companies totaling \$175.3 million, including two companies that fully repaid outstanding loans totaling \$12.5 million, as compared to debt investments in five portfolio companies totaling \$16.7 million in 2004. We also made equity investments

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in six portfolio companies in 2005 totaling \$3.5 million, including \$1.0 million of debt converted into equity. In addition, we exercised a warrant in one public company bringing total equity investments at fair value to approximately \$4.9 million at December 31, 2005. At December 31, 2005 we have unfunded contractual commitments of \$30.2 million to six portfolio companies.

Total portfolio investment activity (exclusive of unearned income) as of and for the periods ended December 31, 2005 and 2004 was as follows:

(\$ in millions)	Year Ended December 31, 2005	Period Ended December 31, 2004
Beginning portfolio	\$ 16.7	\$
Loan originations	175.3	16.7
Equity investments	2.5	
Gross payments/Reductions	(6.3)	
Early pay-offs	(12.5)	
Accretion of loan discounts	0.4	
Unrealized appreciation in investments	4.0	
Unrealized depreciation in investments	(3.4)	
Ending portfolio	<u>\$ 176.7</u>	<u>\$ 16.7</u>

The following table shows the fair value of our portfolio of investments by asset class as of December 31, 2005 and 2004 (excluding unearned income):

(\$ in millions)	Year Ended		Period Ended	
	December 31, 2005		December 31, 2004	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
Senior debt with warrants	\$ 163.4	92.4%	\$ 12.7	76.0%
Subordinated debt	8.4	4.8%	4.0	24.0%
Preferred stock	3.5	2.0%		
Common stock	1.4	0.8%		
	<u>\$ 176.7</u>	<u>100.0%</u>	<u>\$ 16.7</u>	<u>100.0%</u>

The following table shows the fair value of our portfolio by industry sector at December 31, 2005 and 2004 (excluding unearned income):

Year Ended

Period Ended

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(\$ in millions)	December 31, 2005		December 31, 2004	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
Biopharmaceuticals	\$ 43.6	24.7%	\$	
Software	29.0	16.4%	12.0	71.8%
Consumer & business products	19.8	11.2%	1.7	10.2%
Communications & networking	32.5	18.4%	3.0	18.0%
Medical devices	14.8	8.4%		
Internet & computer services	8.7	4.9%		
Electronics & computer hardware	17.8	10.1%		
Semiconductors	10.5	5.9%		
	<u>\$ 176.7</u>	<u>100.0%</u>	<u>\$ 16.7</u>	<u>100.0%</u>



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We use an investment grading system, which grades each investment on a scale of 1 to 5, to characterize and monitor our expected level of returns on both the debt investments and related warrants or equity positions for each investment in our portfolio. See Business Investment Process Loan and Compliance Administration. The following table shows the distribution of our outstanding debt investments on the 1 to 5 investment grading scale at fair value as of December 31, 2005 and 2004:

(\$ in millions)	December 31, 2005		December 31, 2004	
	Investments at Fair Value	Percentage of Total Portfolio	Investments at Fair Value	Percentage of Total Portfolio
<b>Investment Grading</b>				
1	\$ 9.9	5.8%	\$ 12.7	76.0%
2	150.3	87.4		
3	5.8	3.4	4.0	24.0
4	4.5	2.7		
5	1.3 <sup>(1)</sup>	0.7		
	<u>\$ 171.8</u>	<u>100.0%</u>	<u>\$ 16.7</u>	<u>100.00%</u>

(1) Reflects the value of the assets of this portfolio company that were sold in January 2006 for which we received approximately \$1.3 million in cash distributions. We received an additional contingent payment of approximately \$239,000 in February 2006. We may receive approximately \$700,000 of future distributions related to this sale but such distributions are contingent on future deliverables.

As of December 31, 2005, our investments had a weighted average investment grading of 2.05.

At December 31, 2005, the weighted average yield to maturity of our loan obligations was approximately 12.87%. Yields to maturity are computed using interest rates as of December 31, 2005 and include amortization of loan facility fees, original issue discounts, commitment fees and market premiums or discounts over the expected life of the debt investments, weighted by their respective costs when averaged and are based on the assumption that all contractual loan commitments have been fully funded.

We generate revenue in the form of interest income, primarily from our investments in debt securities, and commitment and facility fees. Fees generated in connection with our debt investments are recognized over the life of the loan or, in some cases, recognized as earned. In addition, we generate revenue in the form of capital gains, if any, on warrants or other equity-related securities that we acquire from our portfolio companies. Our investments generally range from \$1.0 million to \$20.0 million, with an average initial principal balance of between \$3.0 million and \$7.0 million. Our debt investments have a term of between two and seven years and typically bear interest at a rate ranging from 8.0% to 14.0% (based on current interest rate conditions). In addition to the cash yields received on our loans, in some instances, our loans may also include any of the following: end-of-term payments, exit fees, balloon payment fees, or prepayment fees, and diligence fees, which may be required to be included in income prior to receipt. In some cases, we collateralize our investments by obtaining security interests in our portfolio companies' assets, which may include their intellectual property. In other cases, we may obtain a negative pledge covering a company's intellectual property. Interest on debt securities is generally payable monthly, with amortization of principal typically occurring over the term of the security for emerging-growth and expansion-stage companies. In addition, certain loans may include an interest-only period ranging from three to six months. In limited instances in which we choose to defer amortization of the loan for a period of time from the date of the initial investment, the principal amount of the debt securities and any accrued but unpaid interest become due at the maturity date. Our mezzanine debt investments also generally have equity enhancement features, typically in the form of warrants or other equity-related securities designed to provide us with an opportunity for capital appreciation.

**Results of Operations**

We commenced operations on February 2, 2004 but did not commence investment activities until September 2004. As a result, the period from February 2, 2004 to December 31, 2004 is not comparable to the period from

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January 1, 2005 to December 31, 2005 and is not indicative of the results to be expected for any future period. Except as noted, references to 2004 refer to the period from February 2, 2004 to December 31, 2004 and references to 2005 refer to the twelve month period ended December 31, 2005.

### **For the periods ended December 31, 2005 and 2004**

#### ***Operating Income***

Interest income totaled approximately \$9.8 million and \$214,000 for 2005 and 2004, respectively. In 2005, interest income included approximately \$351,000 of revenue from accrued exit fees. Income from commitment and facility fees totaled approximately \$875,000 and \$0 for 2005 and 2004, respectively. The increases are the result of origination activity and yield from investments. At December 31, 2005, we had approximately \$2.7 million of deferred revenue related to commitment and facility fees. We expect to generate additional interest income and loan commitment fees as we continue to originate additional investments.

#### ***Operating Expenses***

Operating expenses totaled approximately \$9.1 million and \$2.3 million during 2005 and 2004, respectively. Operating expenses for 2005 included interest expense, loan fees and unused commitment fees under our Bridge Loan Credit Facility and the Citigroup Facility of approximately \$2.9 million. There were no interest or loan fees in 2004. Employee compensation and benefits were approximately \$3.7 million and \$1.2 million during 2005 and 2004, respectively. The increase in employee compensation and benefits is due to increased number of employees from 11 to 19 and bonuses of approximately \$1.3 million paid in 2005. General and administrative expenses increased to \$2.3 million from \$411,000 in 2004 primarily due to increased legal expenses, professional service costs related to our status as a public company and the creation of our SBIC subsidiaries as well as increased business development expenses. In addition, we incurred approximately \$252,000 of stock-based compensation expense in 2005 as compared to \$680,000 in 2004. The decrease in stock-based compensation expense was due to the immediate vesting of certain options granted in 2004. We anticipate that operating expenses will increase over the next twelve months as we continue to incur higher interest expense on higher average outstanding debt balances, increase the number of our employees to support our growth and incur additional expenses related to being a public company, including expenses related to the implementation of the requirements under Sarbanes-Oxley Act.

#### ***Net Investment Income (Loss) Before Income Tax Expense and Investment Gains and Losses***

Net investment income before income tax expense for the year ended December 31, 2005 totaled \$1.5 million as compared with a net investment loss before income tax expense in 2004 of approximately \$2.0 million. This change is made up of the items described above.

#### ***Net Investment Gains***

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For the period ended December 31, 2005, net unrealized investment appreciation totaled approximately \$353,000. The net unrealized appreciation and depreciation of investments is based on portfolio asset valuations determined in good faith by our Board of Directors, based on the recommendations of the Valuation Committee of our Board of Directors. For the year ended December 31, 2005, we recognized approximately \$4.1 million of gross unrealized appreciation on 14 of our portfolio investment companies and approximately \$3.4 million of gross unrealized depreciation on 15 of our portfolio investment companies. See Recent Developments. Approximately \$3.3 million of the unrealized depreciation was due to a reduction in the fair value of one portfolio company. The net unrealized investment gains recognized by the company were reduced by approximately \$342,000 for a warrant participation agreement with Citigroup. We generated a net realized gain totaling approximately \$482,000 from the sale of common stock of one biopharmaceutical portfolio company. We did not recognize any realized or unrealized gains or losses during the period ended December 31, 2004.

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### ***Income Taxes***

We are taxed under Subchapter C of the Internal Revenue Code and therefore are subject to corporate-level federal and state income tax.

We account for income taxes in accordance with the provisions of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, which requires that deferred income taxes be determined based upon the estimated future tax effects of differences between the financial statement and tax basis of assets and liabilities given the provisions of the enacted tax law. Valuation allowances are used to reduce deferred tax assets to the amount likely to be realized.

We intend to seek to be treated as a RIC under Subchapter M of the Code for 2006. However, such an election and qualification to be treated as a RIC requires that we comply with certain requirements contained in Subchapter M of the Code that may affect our ability to pursue additional business opportunities or strategies which, if we were to determine we should pursue such strategies, may diminish the desirability of or impede our ability to qualify as a RIC. For example, a RIC must meet certain requirements, including source-of-income, asset diversification and income distribution requirements. The income source requirement mandates that we receive 90% or more of our income from qualified earnings, typically referred to as good income. Qualified earnings may exclude such income as management fees received in connection with our SBIC or other potential outside managed funds and certain other fees. As of the date of this report, we cannot determine the probability that during 2006 we will qualify as RIC when we file our 2006 federal tax return. See Certain United States Federal Tax Considerations Taxation as a Regulated Investment Company.

As such, we have elected to report our financial position and results of operations under Subchapter C of the Code until such time as we can reasonably ascertain that we will meet the required qualifications as a RIC. As a C corporation, we will accrue income tax expense on a quarterly basis until we are able to reasonably determine that we will qualify as a RIC under requirements contained in Subchapter M of the Code. If and when, during 2006, we are able to reasonably determine that we can qualify as a RIC, we would reverse any income tax expense recorded during 2006 and charge to income tax expense the \$1.4 million deferred tax asset on the our balance sheet at December 31, 2005. If we had been able to make the determination as of December 31, 2005, the impact of charging the deferred tax to operations would have reduced our NAV by approximately \$0.15 per share.

### ***Net Increase in Net Assets Resulting from Operations and Earnings Per Share***

For the year ended December 31, 2005 net income totaled approximately \$2.1 million compared to a net loss of approximately \$2.0 million for the period ended December 31, 2004. These changes are made up of the items previously described.

Basic and diluted net income per share for the year ended December 31, 2005 was \$0.30 as compared to a basic loss per share of \$1.72 and diluted loss per share of \$1.58 for the period ended December 31, 2004. The net income per share for 2005 was affected by an increase in the number of average shares outstanding in 2005 as compared to 2004 of approximately 5.9 million shares and 5.7 million shares on a basic and diluted basis, respectively.

### **Financial Condition, Liquidity and Capital Resources**

## Edgar Filing: HERCULES TECHNOLOGY GROWTH CAPITAL INC - Form N-2/A

We were initially capitalized with approximately \$2.6 million in proceeds from the sale of preferred stock in February 2004. In June 2004, we completed an additional private placement offering of 904,635 units at a price of approximately \$30.00 per unit. Each unit consisted of two shares of our common stock and two warrants to purchase one share of our common stock at a price of \$15.00 per share. All of our then outstanding preferred stock was exchanged for units concurrent with the closing of our private offering in June 2004. We received

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approximately \$23.9 million in total net proceeds from the June 2004 private offering, net of placement fees and other offering-related costs. In February 2005, warrants to purchase 1,175,963 shares of our common stock were exercised, generating proceeds to us of approximately \$12.4 million.

In June 2005, we completed our initial public offering of 6,000,000 shares of our common stock at a price of \$13.00 per share resulting in net proceeds to us of approximately \$70.9 million after deducting offering costs.

On September 7, 2005, we registered 3,801,905 shares of common stock and 673,223 5-year warrants pursuant to its obligations under a registration rights agreement between Hercules and certain shareholders. Prior to registration, these shares of common stock and warrants were restricted within the meaning of the Securities Act of 1933. We did not receive any proceeds from the registration of these securities.

For 2005, net cash used in operating activities totaled \$156.7 million as compared to \$17.7 million in 2004. This increase was due primarily to \$177.8 million used for investments in our portfolio company s, offset by approximately \$18.8 million in principal repayments, as compared to \$16.7 million of investments in our portfolio company s in 2004. Cash provided by investing activities in 2005 totaled \$447,000 and was primarily due to proceeds of approximately \$531,000 from the sale of common stock in one portfolio company offset by purchases of capital assets and other long-term assets of \$84,000. We used \$43,000 of cash in investing activities in 2004 that was primarily related to purchases of capital equipment. Net cash provided by financing activities totaled \$162.9 million in 2005 as compared to \$26.4 million in 2004. In 2005, we received \$87.2 million in proceeds from the sale of common stock and \$76.0 million from borrowings under our credit facilities, offset by a dividend payment of \$245,000. In 2004 we received approximately \$26.4 million from the sale of preferred and common stock.

As of December 31, 2005, net assets totaled \$114.4 million, with a net asset value per share of \$11.67, and we had approximately \$15.4 million in cash and cash equivalents. We intend to generate additional cash primarily from future borrowings as well as cash flows from operations, including income earned from investments in our portfolio companies and, to a lesser extent, from the temporary investment of cash in U.S. government securities and other high-quality debt investments that mature in one year or less. Our primary use of funds will be investments in portfolio companies and cash distributions to holders of our common stock. After we have used our current capital resources, we expect to raise additional capital to support our future growth through future equity offerings, issuances of senior securities and/or future borrowings, to the extent permitted by the 1940 Act.

As defined under the 1940 Act, our asset coverage must be at least 200% after each issuance of senior securities. Our asset coverage as of December 31, 2005 was approximately 250%.

We anticipate that we will continue to fund our investment activities through a combination of debt and additional equity capital over the next year. As of December 31, 2005, based on eligible loans in the investment portfolio and existing advance rates, we had approximately \$19.0 million of borrowing capacity available under our existing \$100 million securitized credit facility from Citigroup, and \$51.0 million of loans outstanding under the facility. As additional new loans are originated and funded, we will be able to increase our borrowing capacity under the Citigroup Facility beyond the current \$19.0 million. Advances under the facility bear interest at one-month LIBOR plus 165 basis points. There was \$51 million outstanding under the Citigroup Facility as of December 31, 2005. We anticipate that portfolio fundings entered into in succeeding periods will allow us to utilize the full borrowing capacity of the Citigroup Facility. We expect to issue additional equity or debt securities within the next two quarters to continue to fund our investing activities.

We estimate that the net proceeds to us from this offering will be approximately \$35.8 million based on an estimated subscription price per share of \$11.08. In addition, we amended our Citigroup Facility agreement to increase the borrowing capacity from \$100.0 million to \$125.0 million.

We believe these funding sources will



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allow us to continue investing activities for 3 to 6 months. In order to fund new originations, we intend to pursue additional equity financings and additional borrowing facilities.

**Off Balance Sheet Arrangements**

In the normal course of business, we are party to financial instruments with off-balance sheet risk. These consist primarily of unfunded commitments to extend credit, in the form of loans, to our portfolio companies. Unfunded commitments to provide funds to portfolio companies will not be reflected on our balance sheet. Our unfunded commitments may be significant from time to time. As of December 31, 2005, we had unfunded commitments of approximately \$30.2 million. These commitments will be subject to the same underwriting and ongoing portfolio maintenance as are the on-balance sheet financial instruments that we hold. Since these commitments may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements.

**Contractual Obligations**

The following table shows our contractual obligations as of December 31, 2005:

Contractual Obligations <sup>(1)</sup>	Payments due by period				
	(dollars in thousands)				
	Total	Less than			After
		1 year	1-3 years	4-5 years	5 Years
Borrowings <sup>(2)</sup>	\$ 76,000	\$ 25,000	\$ 51,000		
Operating lease obligations	244	244			
<b>Total</b>	<b>\$ 76,244</b>	<b>\$ 25,244</b>	<b>\$ 51,000</b>		

(1) Excludes commitments to extend credit to our portfolio companies.

(2) Borrowings under our Citigroup credit facility are listed based on the contractual maturity of the credit facility. Actual repayments could differ significantly due to prepayments by our existing portfolio companies, modifications of our current agreements with our existing portfolio companies and modification of the credit facility. See Recent Developments.

**Borrowings**

In April 2005, we entered into a bridge loan credit facility with Alcmene, a special purpose vehicle that is an affiliate of Farallon Capital Management, L.L.C., a shareholder of Hercules, which we refer to as the Bridge Loan Credit Facility. The Bridge Loan Credit Facility is a \$25 million secured term loan, which provides for \$25 million of available borrowings, all of which was drawn down on April 12, 2005. The Bridge Loan Credit Facility allows for up to an additional \$25 million of discretionary supplemental senior secured loans. See Obligations and Indebtedness. All amounts outstanding under this credit facility were initially due and payable on October 12, 2005.

On August 1, 2005, we amended our Bridge Loan Credit Facility with Alcmene Funding, LLC. The amended agreement extended the term of the loan to April 12, 2006, eliminated the loan extension fee, revised the interest rate effective August 1, 2005 to LIBOR plus 5.6% through December 31, 2005 and thereafter to 13.5% per annum, and amended certain collateral rights and financial covenants. At December 31, 2005, the interest rate under the Bridge Loan Credit Facility was 9.76% per year. We had \$25.0 million of outstanding borrowings under the Bridge Loan Credit Facility at December 31, 2005. On March 6, 2006, we repaid \$10 million of the Bridge Loan Credit Facility, and the interest rate was reduced to 10.86%. See Recent Developments.

On August 1, 2005, we, through Hercules Funding Trust I, our affiliated statutory trust, executed a \$100 million securitized credit facility with Citigroup Global Markets Realty Corp., which we refer to as the Citigroup Facility. Our ability to make draws on the Citigroup Facility expires on July 31, 2006 unless extended prior to such date for an additional 364-day period with the lender's consent. If the Citigroup Facility is not extended, any principal amounts then outstanding will be amortized over a six-month period through a termination date in

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January 2007. The Citigroup Facility is collateralized by loans from our portfolio companies, and includes an advance rate of approximately 55% of eligible loans. Interest on borrowings under the Citigroup Facility will be paid monthly and will be charged at one-month LIBOR plus a spread of 1.65%. We also paid a loan origination fee equal to 0.25% of the Citigroup Facility and will be subject to an unused commitment fee of 0.50% until the earlier of borrowing \$50.0 million under the facility or February 1, 2006, and 0.25% thereafter. The Citigroup Facility contains covenants that, among other things, require us to maintain a minimum net worth and to restrict the loans securing the Citigroup Facility to certain dollar amounts, to concentrations in certain geographic regions and industries, to certain loan grade classifications, to certain security interests and to certain interest payment terms. There was \$61.0 million of outstanding borrowings under the Citigroup Facility at February 28, 2006. We recently increased the size of our Citigroup Facility to \$125 million. See Recent Developments.

In addition, we expect to pursue additional debt financing from the Small Business Administration under its Small Business Investment Company program. We may also seek to enter into an additional securitization facility. See Obligations and Indebtedness.

There can be no assurance that we will be successful in obtaining any additional debt capital on terms acceptable to us, or at all. If we are unable to obtain debt capital, then our equity investors will not benefit from the potential for increased returns on equity resulting from leverage to the extent that our investment strategy is successful. While there can be no assurance that we will be able to borrow from banks or other financial institutions, we expect that we will at some time in the future obtain additional securitized credit facilities. The current lenders have and any future lender or lenders will have fixed dollar claims on our assets that are senior to the claims of our stockholders and, thus, will have a preference over our stockholders with respect to our assets. In addition, we may grant a security interest in our assets in connection with any such borrowing. We expect such a facility to contain customary default provisions such as a minimum net worth amount, a profitability test and a restriction on changing our business and loan quality standards. An event of default under any credit facility would likely result, among other things, in termination of the availability of further funds under that facility and an accelerated maturity date for all amounts outstanding under the facility, which would likely disrupt our business and, potentially, the business of the portfolio companies whose loans that we financed through the facility. This could reduce our revenues and, by delaying any cash payment allowed to us under our facility until the lender has been paid in full, reduce our liquidity and cash flow and impair our ability to grow our business. See Obligations and Indebtedness.

## **Distributions**

On October 27, 2005, we declared our first dividend of \$0.025 per common share for holders of record on November 1, 2005. This dividend totaled approximately \$245,000 and was distributed on November 17, 2005. On December 9, 2005 we declared a dividend of \$0.30 per share for stockholders of record on January 6, 2006. The dividend totaled approximately \$2.9 million and was distributed on January 27, 2006.

## **RIC Election**

We intend to seek to be taxed as a RIC under Subchapter M of the Code for 2006. However, such an election and qualification to be treated as a RIC requires that we comply with certain requirements contained in Subchapter M of the Code that may affect our ability to pursue additional business opportunities or strategies which, if we were to determine we should pursue, may diminish the desirability of or impede our ability to qualify as a RIC. For example, in order to qualify as a RIC and obtain the tax benefits of such status, a corporation must meet certain requirements, including a qualified source-of-income, asset diversification and income distribution requirements. The income source requirement mandates that we receive 90% or more of our income from qualified earnings, typically referred to as good income. Qualified earnings may exclude such income as management fees received in connection with our SBIC or other potential outside managed funds and certain other fees. As of the date of this report, we cannot determine the probability that during 2006 we will qualify as RIC when we file our 2006 federal tax return.



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As such, we have elected to report our financial position and results of operations under Subchapter C of the Code until such time as we can reasonably ascertain that we will meet the required qualifications for a RIC. As a C corporation, we will accrue income tax expense on a quarterly basis until we are able to reasonably determine that we will qualify as a RIC under the requirements contained in Subchapter M of the Code. If and when, during 2006, we are able to reasonably determine that we can qualify as a RIC, we will reverse any income tax expense recorded during 2006 and charge to income tax expense the \$1.4 million deferred tax asset on our balance sheet at December 31, 2005. If we had been able to make the determination as of December 31, 2005, the impact of charging the deferred tax to operations would have reduced our NAV by approximately \$0.15 per share.

As long as we qualify as a RIC, we will not be taxed on our investment company taxable income or realized net capital gains, to the extent that such taxable income and gains are distributed to stockholders on a timely basis. We may be required, however, to pay federal income taxes on any unrealized net built-in gains in the assets held by us during the period in which we were not (or in which we failed to qualify as) a RIC that are recognized within the following 10 years, unless we make a special election to pay corporate-level tax on such built-in gains at the time of our RIC election or an exception applies. See Certain United States Federal Income Tax Considerations Conversion to Regulated Investment Company Status. Annual tax distributions generally will differ from net income for the fiscal year due to temporary and permanent timing differences in the recognition of income and expenses, returns of capital and net unrealized appreciation or depreciation, which are not included in taxable income.

In order to qualify as a RIC under Subchapter M of the Code, and to avoid corporate level tax on any distributed income, we must, in general, for each taxable year: (1) have in effect at all times during the taxable year an election to be treated as a business development company, (2) derive at least 90% of our gross income from dividends, interest, gains from the sale of securities and other specified types of income, (3) meet asset diversification requirements as defined in the Code, and (4) distribute to stockholders at least 90% of our investment company taxable income as set forth in the Code. In addition, prior to the end of our first taxable year as a RIC, we must distribute to our stockholders all earnings and profits from periods prior to our qualification as a RIC.

If we qualify and elect for tax treatment as a RIC, we intend to take the steps necessary to qualify for the federal tax benefits allowable to RICs, including distributing annually to our stockholders at least 90% of our ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses. Unless a stockholder elects otherwise, these distributions will be reinvested in additional shares of our common stock through our dividend reinvestment plan. While we are a RIC, we generally intend to retain any realized net long-term capital gains in excess of realized net short-term capital losses and to elect to treat such net capital gain as deemed distributions to our stockholders. We may, in the future, make actual distributions to our stockholders of some or all of such net capital gains. See Certain United States Federal Income Tax Considerations Taxation as a Regulated Investment Company and Dividend Reinvestment Plan. There can be no assurance that we will qualify for treatment as a RIC in 2006 or in any future years.

We may not be able to achieve operating results that will allow us to make distributions at a specific level or to increase the amount of these distributions from time to time. In addition, we may be limited in our ability to make distributions due to (i) the asset coverage test for borrowings applicable to us as a business development company under the 1940 Act and (ii) provisions in our future credit facilities, if any. If we do not distribute a certain percentage of our income annually, we will suffer adverse tax consequences, including possible loss of the federal income tax benefits allowable to a RIC. We cannot assure stockholders that they will receive any distributions or distributions at any particular level.

## **Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets



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and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the period reported. On an ongoing basis, our management evaluates its estimates and assumptions, which are based on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates. Changes in our estimates and assumptions could materially impact our results of operations and financial condition.

**Valuation of Portfolio Investments.** The most significant estimate inherent in the preparation of our financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded.

As a business development company, we invest primarily in illiquid securities, including debt and equity-related securities of private companies. Our investments are generally subject to restrictions on resale and generally have no established trading market. Because of the type of investments that we make and the nature of our business, our valuation process requires an analysis of various factors. Our valuation methodology includes the examination of, among other things, the underlying investment performance, financial condition and market changing events that impact valuation.

At December 31, 2005, approximately 91% of our total assets represented investments in portfolio companies recorded at fair value. Value, as defined in Section 2(a) (41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) for all other securities and assets, fair value is as determined in good faith by the Board of Directors. Since there is typically no readily available market value for the investments in our portfolio, we value substantially all of our investments at fair value as determined in good faith by our Board of Directors pursuant to a valuation policy and a consistent valuation process. Due to the inherent uncertainty in determining the fair value of investments that do not have a readily available market value, the fair value of our investments determined in good faith by our Board of Directors may differ significantly from the value that would have been used had a ready market existed for such investments, and the differences could be material.

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. Unlike banks, we are not permitted to provide a general reserve for anticipated loan losses. Instead, we must determine the fair value of each individual investment on a quarterly basis. We will record unrealized depreciation on investments when we believe that an investment has decreased in value, including where collection of a loan or realization of an equity security is doubtful. Conversely, where appropriate, we will record unrealized appreciation if we believe that the underlying portfolio company has appreciated in value and, therefore, that our investment has also appreciated in value.

With respect to private debt and equity securities, each investment is valued using industry valuation benchmarks and, where appropriate, the value is assigned a discount reflecting the illiquid nature of the investment, and our minority, non-control position. When a qualifying external event such as a significant purchase transaction, public offering, or subsequent debt or equity sale occurs, the pricing indicated by the external event will be used to corroborate our private debt or equity valuation.

**Interest Income.** Interest income is recorded on the accrual basis to the extent that such amounts are expected to be collected. Original issue discounts are amortized into interest income as adjustments to the related loan's yield over the contractual life of the loan. We stop accruing interest on our investments when it is determined that interest is no longer collectible.

**Fee Income.** Fee income includes loan commitment and facility fees for due diligence and structuring, as well as fees for transaction services and management services rendered by us to portfolio companies and other third parties. These fees are generally recognized as income over the life of the loan or when the services are rendered.





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**Stock-Based Compensation.** We have issued and may, from time to time, issue additional stock options to employees under our 2004 Equity Incentive Plan. We follow Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payments* ( FAS 123R ), to account for stock options granted. Under FAS 123R, compensation expense associated with stock-based compensation is measured at the grant date based on the fair value of the award and is recognized over the vesting period. Determining the appropriate fair value model and calculating the fair value of stock-based awards at the grant date requires judgment, including estimating stock price volatility forfeitures and expected option life.

## **Recent Developments**

At December 31, 2005, we reduced the fair value of an investment in one portfolio company by approximately \$3.3 million to the expected realizable fair value of \$1.3 million. In January 2006, the principle assets of the portfolio company were sold, and we received a cash distribution of approximately \$1.3 million. On February 6, 2006, we received an additional contingent cash distribution of \$239,000 which will be accounted for as a loss recovery in the first quarter of 2006. Terms of the asset sale agreement call for two additional contingent payments of up to \$500,000 each from which we are contractually entitled to receive approximately \$350,000 each, but the conditions of the agreement make receipt and amount of payments uncertain and we will account for any future receipts as loss recoveries at the time of payment.

In December 2005, we declared a dividend of \$0.30 per share for shareholders of record on January 6, 2006. The dividend payment totaling approximately \$2.9 million was distributed to shareholders on January 27, 2006.

On March 6, 2006, we increased our Citibank credit facility from \$100 million to \$125 million. As of February 28, 2006, we had \$61.0 million outstanding under the Citibank credit facility.

On March 6, 2006, we entered into an agreement to repay \$10.0 million of the \$25.0 million outstanding under our loan with an affiliate of Farallon Capital. We extended the maturity of the remaining \$15.0 million from April 12, 2006 to June 30, 2006 and decreased the interest rate from 13.5% to 10.86% per annum.

On March 2, 2006, various funds affiliated with Farallon agreed to purchase \$5.0 million of our common stock at a price per share equal to the net asset value at February 28, 2006. On March 20, 2006, we completed the sale of 432,900 shares of common stock to the Farallon funds at a price per share of \$11.55, which was the net asset value at February 28, 2006.

## **Recent Accounting Pronouncements**

Recent accounting pronouncements are not considered to have a significant impact on our financial statements.

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**OBLIGATIONS AND INDEBTEDNESS**

On April 12, 2005, we entered into a Bridge Loan Credit Facility with an affiliate of Farallon Capital Management, L.L.C. to provide us with additional capital to invest prior to the completion of our initial public offering. In addition, on August 1, 2005, we completed the Citigroup Facility, a securitized credit facility. We expect to pursue additional debt financing from the Small Business Administration under its Small Business Investment Company program. We may seek to enter into additional securitization facilities. These various types of facilities are described below.

There can be no assurance that we will be successful in obtaining any additional debt capital on terms acceptable to us, or at all. If we are unable to obtain debt capital, then positive investment returns for our equity investors, if any, will not benefit from the potential for increased returns on equity resulting from leverage to the extent that our investment strategy is successful. While there can be no assurance that we will be able to borrow from banks or other financial institutions, we expect that we will at some time in the future obtain additional securitized credit facilities. The current lenders have and any future lender or lenders will have fixed dollar claims on our assets that are senior to the claims of our stockholders and, thus, will have a preference over our stockholders with respect to our assets. In addition, we may grant a security interest in our assets in connection with any such borrowing. We expect such a facility to contain customary default provisions such as a minimum net worth amount, a profitability test, and a restriction on changing our business and loan quality standards. An event of default under any credit facility would likely result, among other things, in termination of the availability of further funds under that facility and an accelerated maturity date for all amounts outstanding under the facility, which would likely disrupt our business and, potentially, the business of the portfolio companies whose loans we financed through the facility. This could reduce our revenues and, by delaying any cash payment allowed to us under our facility until the lender has been paid in full, reduce our liquidity and cash flow and impair our ability to grow our business.

**Bridge Financing**

On April 12, 2005, we entered into a Bridge Loan Credit Facility with Alcmene Funding, L.L.C., a special purpose vehicle that is an affiliate of Farallon Capital Management, L.L.C., a shareholder of the Company. On March 6, 2006, we repaid \$10 million of the Bridge Loan Credit Facility. The Bridge Loan Credit Facility consists of a \$15 million senior secured first lien term loan. The Bridge Loan Credit Facility initially matured on October 12, 2005, subject to one six-month extension at our election. Under the original terms of the Bridge Loan Credit Facility, if we elected to extend the maturity date, we would have paid an extension fee of 1% of the principal amount of the outstanding loan. The Bridge Loan Credit Facility is prepayable by us at any time without premium or penalty. The entire principal amount of the Loan is due at maturity. Borrowings under the Bridge Loan Credit Facility originally bore interest at 8.0% per annum through the initial maturity date, and, if we elected to extend the maturity date of the Bridge Loan Credit Facility beyond the initial six-month term, borrowings were to bear interest at 11.5% per annum during any such extension period. In addition, we paid an upfront fee of \$500,000 at the time of our initial draw down under the facility and will be obligated to pay a maturity fee of \$500,000 upon repayment of the Bridge Loan Credit Facility, whether upon maturity or upon earlier repayment. The Bridge Loan Credit Facility contains a mandatory prepayment provision requiring that we turn over to Alcmene all principal payments that we receive from our loans to portfolio companies if at such time we have less than \$5 million in cash or cash equivalents on hand. The Bridge Loan Credit Facility is secured by a first priority lien on substantially all of our assets. Interest on our Bridge Loan Credit Facility is payable in arrears monthly, on the maturity date and on any prepayment date.

On August 1, 2005, we amended the Bridge Loan Credit Facility. The amendment agreement extended the term of the Bridge Loan Credit Facility to April 12, 2006, eliminated the loan extension fee, revised the interest rate effective August 1, 2005 to LIBOR plus 5.6% through December 31, 2005 and thereafter to 13.5% per annum, and amended certain collateral rights and financial covenants. On March 6, 2006 we amended the Bridge Loan Credit Facility to extend the due date to June 30, 2006 and reduced the interest rate to 10.86%.

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Our Bridge Loan Credit Facility requires us to meet financial tests with respect to a minimum fixed charge coverage ratio, a minimum senior secured debt coverage ratio, minimum net assets and minimum net assets per share as well as concentration and default limits with respect to portfolio company loans. In addition, our Bridge Loan Credit Facility contains negative covenants limiting, among other things, additional liens and indebtedness, transactions with affiliates, mergers and consolidations, liquidations and dissolutions, sales of assets, dividends, loans and advances (other than to our portfolio companies), and other matters customarily restricted in such agreements. Our Bridge Loan Credit Facility contains customary events of default, including, without limitation, payment defaults, breaches of representations and warranties, covenant defaults, events of bankruptcy and insolvency, failure of any security document supporting the Bridge Loan Credit Facility to be in full force and effect, and a change of control of our business. At December 31, 2005 we were in compliance with the covenants of the Bridge Loan Credit Facility.

### **Securitized Credit Facility**

On August 1, 2005, we, through Hercules Funding Trust I, an affiliated statutory trust, executed a \$100 million securitized credit facility with Citigroup Global Markets Realty Corp., which we refer to as the Citigroup Facility. On March 6, 2006, we amended the Citigroup Facility to increase the available credit to \$125 million. Our ability to draw on the Citigroup Facility expires on July 31, 2006 unless extended prior to such date for an additional 364-day period with the lenders' consent. If the Citigroup Facility is not extended, any principal amounts then outstanding will be amortized over a six-month period through a termination date in January. The Citigroup Facility will be collateralized by loans from our portfolio companies, and includes an advance rate of approximately 55% of eligible loans. Interest on borrowings under the Citigroup Facility will be paid monthly and will be charged at one-month LIBOR plus a spread of 1.65%. We also paid a loan origination fee equal to 0.25% of the Citigroup Facility and will be subject to an unused commitment fee of 0.50% until the earlier of our borrowing \$50.0 million under the facility or February 1, 2006, and 0.25% thereafter. The Citigroup Facility contains covenants that, among other things, require us to maintain a minimum net worth and to restrict the loans securing the Citigroup Facility to certain dollar amounts, to concentrations in certain geographic regions and industries, to certain loan grade classifications, to certain security interests, and to certain interest payment terms. There was \$61.0 million of borrowings outstanding under the Citigroup Facility at February 28, 2006.

### **SBIC Financing**

We are pursuing, through our wholly-owned subsidiary Hercules Technology II, L.P., additional debt financing from the Small Business Administration under its Small Business Investment Company program. If we are able to obtain financing under such program, we will be subject to regulation and oversight by the Small Business Administration, including requirements with respect to maintaining certain minimum financial ratios and other covenants. The Small Business Investment Company regulations currently limit the amount that is available to borrow by any SBIC to \$119 million. There is no assurance that we will draw up to the maximum limit available under the Small Business Investment Company program.

In January 2005, we formed Hercules Technology II, L.P. ( HT II ) and Hercules Technology SBIC Management, LLC (HTM). On May 3, 2005, HT II filed an application with the Small Business Administration (the SBA ) to become licensed as a Small Business Investment Company ( SBIC ) and on June 24, 2005, the HT II received a letter of acknowledgement of receipt of this application. Upon receipt of this letter from the SBA, HT II was eligible to make pre-approved investments. If HT II's application to the SBIC program is ultimately approved by the SBA, then it will be able to borrow funds from the SBA against eligible pre-approved investments. During 2005, HT II funded two preapproved loans of which one was fully repaid in October 2005. At December 31, 2005, Hercules had a net investment of \$2.5 million in HT II and there is one outstanding loan in the amount of \$2.0 million. HTM is our wholly-owned subsidiary. Hercules is the sole limited partner of HT II and HTM is the general partner.

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**Securitization**

We plan to aggregate pools of funded loans using the Citigroup Facility or other conduits that we may seek until a sufficiently large pool of funded loans is created which can then be securitized. We expect that any loans included in a securitization facility will be securitized on a non-recourse basis with respect to the credit losses on the loans. There can be no assurance that we will be able to complete this securitization strategy, or that it will be successful.

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**BUSINESS**

**General**

We are a specialty finance company that provides debt and equity growth capital to technology-related and life-sciences companies at all stages of development. We primarily finance privately-held companies backed by leading venture capital and private equity firms and also may finance certain select publicly-traded companies that lack access to public capital or are sensitive to equity ownership dilution. We source our investments through our principal office located in Silicon Valley, as well as our additional offices in the Boston, Boulder and Chicago areas. Our goal is to be the leading structured mezzanine capital provider of choice for venture capital and private equity-backed technology-related and life sciences companies requiring sophisticated and customized financing solutions. We invest primarily in structured mezzanine debt and, to a lesser extent, in senior debt and equity. We use the term structured mezzanine debt investment to refer to any debt investment, such as a senior or subordinated secured loan, that is coupled with an equity component, including warrants, options or rights to purchase common or preferred stock. Our structured mezzanine debt investments will typically be secured by some or all of the assets of the portfolio company.

We focus our investments in companies active in the technology industry sub-sectors characterized by products or services that require advanced technologies, including computer software and hardware, networking systems, semiconductors, semiconductor capital equipment, information technology infrastructure or services, Internet consumer and business services, telecommunications, telecommunications equipment, media and life sciences. Within the life sciences sub-sector, we focus on medical devices, bio-pharmaceutical, health care services and information systems companies. We refer to all of these companies as technology-related companies and intend, under normal circumstances, to invest at least 80% of the value of our assets in such businesses.

Our investment objective is to maximize our portfolio's total return by generating current income from our debt investments and capital appreciation from our equity-related investments. We are an internally-managed, non-diversified closed-end investment company that has elected to be treated as a business development company under the Investment Company Act of 1940.

Our primary business objectives are to increase our net income, net operating income and net asset value by investing in structured mezzanine debt and equity of venture capital and private equity backed technology-related companies with attractive current yields and the potential for equity appreciation and realized gains. Our structured debt investments typically include warrants or other equity interests, giving us the potential to realize equity-like returns on a portion of our investment. In some cases, we receive the right to make additional equity investments in our portfolio companies in connection with future equity financing rounds. Capital that we provide directly to venture capital and private equity backed technology-related companies is generally used for growth, and in select cases for acquisitions or recapitalizations.

Our portfolio is comprised of, and we anticipate that our portfolio will continue to be comprised of, investments in technology-related companies at various stages of their development. Our emphasis is on private companies following or in connection with their first institutional round of equity financing, which we refer to as emerging-growth companies, and private companies in later rounds of financing, which we refer to as expansion-stage companies. To a lesser extent, we make investments in established companies comprised of private companies in one of their final rounds of equity financing prior to a liquidity event or select publicly-traded companies that lack access to public capital or are sensitive to equity ownership dilution.

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From incorporation through December 31, 2005, we were taxed as a corporation under Subchapter C of the Internal Revenue Code of 1986, as amended, which we refer to in this prospectus as the Code. We currently intend to seek to be treated for federal income tax purposes as a RIC under Subchapter M of the Code with the filing of our federal corporate income tax return for 2006, which election, when actually made, would be effective as of January 1, 2006. As a RIC, we generally will not pay corporate-level federal income taxes on any ordinary income or capital gains that we distribute to our stockholders as dividends. We may be required, however, to pay corporate-level federal income taxes on gains built into our assets as of the effective date of our RIC election. See **Certain United States Federal Income Tax Considerations Conversion to Regulated Investment Company Status.** To obtain and maintain the federal income tax benefits of RIC status, we must meet specified source-of-income and asset diversification requirements and distribute annually an amount equal to at least 90% of the sum of our net ordinary income and realized net short-term capital gains in excess of realized net long-term capital losses, if any, out of assets legally available for distribution. See **Distributions.** There is no assurance that we will meet these tests and be eligible to make a RIC election. As of the date of this prospectus, we cannot determine the probability that during 2006 we will qualify as a RIC when we file our 2006 tax return. If we do not qualify or elect to make a RIC election, we would continue to be taxed as a C corporation.

We commenced investment operations in September 2004. At December 31, 2005, we had outstanding structured mezzanine debt investments in 31 portfolio companies representing approximately \$171.8 million and equity investments of \$4.9 million for a total investment portfolio at fair value of \$176.7 million. In addition, at December 31, 2005, we had unfunded contractual commitments of \$30.2 million.

At December 31, 2005, the weighted average yield to maturity of our loan obligations was approximately 12.87%. Yields to maturity are computed using interest rates as of December 31, 2005 and include amortization of loan facility fees, original issue discounts, commitment fees and market premiums or discounts over the expected life of the debt investments, weighted by their respective costs when averaged and are based on the assumption that all contractual loan commitments have been fully funded.

## **Corporate History and Offices**

We were founded by Mr. Henriquez, our Chief Executive Officer, Mr. Howard, our Senior Managing Director, and Mr. Harvey, our Chief Legal Officer, in December 2003, and we were incorporated in Maryland on December 18, 2003. We were initially capitalized with approximately \$2.6 million in net proceeds from the sale of our preferred stock in February 2004.

In June 2004, we completed a private offering of units, each unit consisting of two shares of our common stock and two warrants to purchase one share of our common stock. We received approximately \$23.9 million in total net proceeds from this private offering, net of placement fees and before other offering and organizational expenses. All of the then-outstanding preferred stock was exchanged for units immediately prior to the closing of our June 2004 private offering.

In June 2005, we completed a public offering of 6,000,000 shares of our common stock at a price of \$13.00 per share resulting in net proceeds to the company of approximately \$70.9 million after deducting the offering costs.

## **Our Market Opportunity**

We believe that technology-related companies compete in one of the largest and most rapidly growing sectors of the U.S. economy and that continued growth is supported by ongoing innovation and performance improvements in technology products as well as the adoption of

technology across virtually all industries in

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response to competitive pressures. We believe that an attractive market opportunity exists for a specialty finance company focused primarily on structured mezzanine investments in technology-related companies for the following reasons:

Technology-related companies are underserved by traditional lending sources;

Unfulfilled demand exists for structured debt financing by technology-related companies;

Structured mezzanine debt products are less dilutive and complement equity financing from venture capital and private equity funds;  
and

Average valuations for private technology-related companies are lower than in recent years.

***Technology-Related Companies Underserved by Traditional Lenders.*** We believe many viable technology-related companies backed by financial sponsors have been unable to obtain sufficient growth financing from traditional lenders, including financial services companies such as commercial banks and finance companies, in part because traditional lenders have continued to consolidate and have adopted a more risk-averse approach to lending that has resulted in tightened credit standards in recent years. More importantly, we believe traditional lenders are typically unable to underwrite the risk associated with financial sponsor-backed emerging-growth or expansion-stage companies effectively.

The unique cash flow characteristics of many technology-related companies as a result of significant research and development expenditures and high projected revenue growth often render them difficult to evaluate from a credit perspective. The balance sheets of emerging-growth and expansion-stage companies often include a disproportionately large amount of intellectual property assets, which makes the process of valuing that collateral more difficult. Finally, the speed of innovation in technology and rapid shifts in consumer demand and market share require an in-depth understanding of technology products and markets. These attributes can make it difficult for lenders to analyze technology-related companies using traditional underwriting methods.

We believe traditional lenders are generally refraining from entering the structured mezzanine debt marketplace for emerging-growth and expansion-stage companies, instead preferring the risk-reward profile of senior debt. Traditional lenders generally do not have flexible product offerings that meet the needs of technology-related companies. The financing products offered by traditional lenders typically impose on borrowers many restrictive covenants and conditions, including limiting cash flows and requiring a significant depository relationship to facilitate rapid liquidation.

***Unfulfilled Demand for Structured Debt Financing by Technology-Related Companies.*** Private debt capital from specialty finance companies continues to be an important source of funding for technology-related companies. We believe that the level of demand for debt financing to emerging-growth and expansion-stage companies is a function of the level of annual venture equity investment activity. In 2005, venture capital-backed companies received, in approximately 2,200 transactions, equity financing in an aggregate amount of approximately \$22.1 billion, as reported by Dow Jones VentureOne/. According to Dow Jones VentureOne/, as of December 31, 2005, there were a total of approximately 5,400 private companies that had received aggregate venture capital equity investments of approximately \$132 billion over the prior six years. We believe a range of \$20 billion to \$25 billion in annual equity investments to venture-backed companies will be sustainable for future years.

We believe that demand for structured debt financing is currently unfulfilled, in part because historically the largest capital providers to technology-related companies have exited the market while at the same time lending requirements of traditional lenders have become more



stringent. We therefore believe we entered the structured lending market for technology-related companies at an opportune time.

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***Structured Mezzanine Debt Products Complement Equity Financing From Venture Capital and Private Equity Funds.*** We believe that structured debt securities will continue to be viewed as an attractive source of capital that will augment the capital provided by venture capital and private equity funds. We believe that our structured mezzanine debt products provide access to growth capital for technology-related companies that may not otherwise be able to obtain financing other than through incremental investments by their existing equity investors. As such, we provide portfolio companies and their financial sponsors with an opportunity to complement and diversify their capital sources. Generally, we believe emerging-growth and expansion-stage companies target a portion of their capital to be debt in an attempt to enable those companies to achieve a higher valuation through internal growth. In addition, because financial-sponsor backed companies have recently been more mature prior to reaching a liquidity event, our investments could provide the debt capital needed to grow or recapitalize during the extended period prior to liquidity events.

***Lower Valuations for Private Technology-Related Companies.*** During the downturn in technology industries that began in 2000, the markets saw sharp and broad declines in valuations of venture capital and private equity-backed technology-related companies. According to Dow Jones VentureOne/Ernst & Young, as of December 31, 2005 median pre-money valuations for venture capital-backed companies in 2005 was \$15.2 million, which compares to \$25.0 million in 2000 and \$16.0 million in 2001. We believe that the valuations currently assigned to venture capital and private equity-backed technology-related companies in private financing rounds will allow us to build a portfolio of equity-related securities at attractive valuation levels.

### **Our Business Strategy**

Our strategy to achieve our investment objective includes the following key elements:

***Leverage the Experience and Industry Relationships of Our Management Team.*** We have assembled a team of senior investment professionals with extensive experience as venture capitalists, commercial lenders, and originators of structured debt and equity investments in technology-related companies. Members of our management team also have operational, research and development and finance experience with technology-related companies. We have established contacts with leading venture capital and private equity fund sponsors, public and private companies, research institutions and other industry participants, which should enable us to identify and attract well-positioned prospective portfolio companies.

We will concentrate our investing activities in industries in which our investment professionals have extensive investment experience. Our investment professionals have, on average, more than 15 years of experience as equity investors in, and/or lenders to, technology-related companies. In addition, our team members have originated structured mezzanine investments in over 200 technology-related companies, representing over \$1 billion in investments, and have developed a network of industry contacts with investors and other participants within the venture capital and private equity communities. We believe that our focus on financing technology-related companies will enable us to leverage our expertise in structuring prospective investments to assess the value of both tangible and intangible assets, to evaluate the business prospects and operating characteristics of technology-related companies, and to identify and originate potentially attractive investments with these types of companies.

***Mitigate Risk of Principal Loss and Build a Portfolio of Equity-Related Securities.*** We expect that our investments will have the potential to produce attractive risk adjusted returns through current income, in the form of interest and fee income, as well as capital appreciation from our equity-related investments. We believe that we can mitigate the risk of loss on our debt investments through the combination of loan principal amortization, cash interest payments, relatively short maturities for our debt instruments, taking security interests in the assets of our portfolio companies, as well as requiring prospective portfolio companies to have certain amounts of available cash at the time of our investment and the continued support from a venture capital or private equity firm at the time we make our investment.



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Our structured debt investments typically include warrants or other equity interests, giving us the potential to realize equity-like returns on a portion of our investment. In addition, we expect, in some cases, to receive the right to make additional equity investments in our portfolio companies in connection with future equity financing rounds. We believe that the valuations currently assigned to technology-related companies in private financing rounds as a result of the recent downturn in technology-related industries will allow us to build a portfolio of equity-related securities at attractive valuation levels, which we believe will create the potential for meaningful long-term capital gains in connection with the future liquidity events of these technology-related companies.

***Provide Customized Financing Complementary to Financial Sponsors' Capital.*** We offer a broad range of investment structures and possess expertise and experience to effectively structure and price investments in technology-related companies. Unlike many of our competitors that structure their products to fit a specific set of investment parameters, we have the flexibility to structure our investments to suit the particular needs of our portfolio companies. We offer customized financing solutions ranging from senior debt to equity capital, with a focus on structured mezzanine debt.

We use our strong relationships in the financial sponsor community to originate investment opportunities. Because venture capital and private equity funds typically invest solely in the equity securities of their portfolio companies, we believe that our debt investments will be viewed as an attractive source of capital, both by the portfolio company and by the portfolio company's financial sponsor. In addition, we believe that many venture capital and private equity fund sponsors encourage their portfolio companies to use debt financing for a portion of their capital needs as a means of potentially enhancing equity returns, minimizing equity dilution and increasing valuations prior to a subsequent equity financing round or a liquidity event.

***Invest at Various Stages of Development.*** We provide growth capital to technology-related companies at all stages of development, from emerging-growth companies, to expansion-stage companies to established companies. We believe that this provides us with a broader range of potential investment opportunities than those available to many of our competitors, who generally choose to make investments during a particular stage in a company's development. Because of the flexible structure of our investments and the extensive experience of our investment professionals, we believe we are well positioned to take advantage of these investment opportunities at all stages of prospective portfolio companies' development.

***Benefit from Our Efficient Organizational Structure.*** We believe that the perpetual nature of our corporate structure enables us to be a long-term partner for our portfolio companies in contrast to traditional mezzanine and investment funds, which typically have a limited life. In addition, because of our access to the equity markets, we believe that we may benefit from a lower cost of capital than that available to private investment funds. We are not subject to requirements to return invested capital to investors nor do we have a finite investment horizon. Capital providers that are subject to such limitations are often required to seek a liquidity event more quickly than they otherwise might, which can result in a lower overall return on an investment.

***Deal Sourcing Through Our Proprietary Database.*** We have developed a proprietary and comprehensive structured query language-based (SQL) database system to track various aspects of our investment process including sourcing, originations, transaction monitoring and post-investment performance. As of December 31, 2005, our proprietary SQL-based database system included over 7,900 technology-related companies and over 1,480 venture capital private equity sponsors/investors, as well as various other industry contacts. This proprietary SQL system allows us to maintain, cultivate and grow our industry relationships while providing us with comprehensive details on companies in the technology-related industries and their financial sponsors.

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**Our Investments and Operations**

We invest in debt securities and, to a lesser extent, equity securities, with a particular emphasis on structured mezzanine debt.

We generally seek to invest in companies that have been operating for at least six to 12 months prior to the date of our investment. We expect that such entities will, at the time of investment, be generating revenues or will have a business plan that anticipates generation of revenues within 24 months. Further, we anticipate that on the date of our investment we will obtain a lien on available assets, which may or may not include intellectual property (other than any tangible assets specifically financed with senior debt), and these companies will have sufficient cash on their balance sheet to amortize their debt for at least nine to 18 months following our investment. We generally require that a prospective portfolio company, in addition to having sufficient capital to support leverage, demonstrate an operating plan capable of generating cash flows or raising the additional capital necessary to cover its operating expenses and service its debt.

We expect that our investments will generally range from \$1.0 million to \$20.0 million. Our debt investments generally have an average initial principal balance of between \$3.0 million and \$7.0 million and have maturities of two to seven years, with an expected average term of three years. We typically structure our debt securities to provide for amortization of principal over the life of the loan, but may include an interest-only period, and our loans will be collateralized by a security interest in the borrower's assets, although we may not have the first claim on these assets and the assets may not include intellectual property. Our debt investments carry fixed or variable contractual interest rates typically ranging from 8% to 14%. In addition to the cash yields received on our loans, in some instances, certain loans may also include any of the following: end of term payments, exit fees, balloon payment fees or prepayment fees, which we may be required to include in income prior to receipt. We also generate revenue in the form of commitment and facility fees, and to a lesser extent, due diligence fees. In addition, our structured mezzanine debt investments will have equity enhancement features, typically in the form of warrants or other equity-related securities designed to provide us with an opportunity for capital appreciation. We generally expect that the warrants typically will be immediately exercisable upon issuance and will remain exercisable for the lesser of seven years or three years after an initial public offering. The exercise prices for the warrants varies from nominal exercise prices to exercise prices that are at or above the current fair market value of the equity for which we receive warrants. We may structure warrants to provide minority rights provisions and put rights upon the occurrence of certain events. We generally target a total annualized return (including interest, fees and value of warrants) of 12% to 25% for our debt investments.

Typically, our debt and equity investments take one of the following forms:

*Structured Mezzanine Debt.* We seek to invest a majority of our assets in structured mezzanine debt of prospective portfolio companies. Traditional mezzanine debt is a layer of high-coupon financing between debt and equity that most commonly takes the form of subordinated debt coupled with warrants, combining the cash flow and risk characteristics of both senior debt and equity. However, our structured mezzanine investments may be the only debt capital on the balance sheet of our portfolio companies, and in many cases we have a first lien security interest in all of our portfolio company's assets (other than any tangible assets specifically financed with senior debt). Our structured mezzanine debt investments typically have maturities of between two and seven years, with full amortization for emerging-growth or expansion-stage companies and little or no amortization for select established companies. Our structured mezzanine debt investments carry a contractual interest rate between 8% and 14% and may include an additional end-of-term payment, are in an amount between \$3 million and \$20 million with an average initial principal balance of between \$3 million and \$7 million (although this investment size may vary proportionately as the size of our capital base changes) and have an average term of three years. In some cases we collateralize our investments by obtaining security interests in our portfolio companies' assets, which may include their intellectual property. In other cases we may obtain a negative pledge covering a company's intellectual property. We may structure our mezzanine debt

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investments with restrictive affirmative and negative covenants, default penalties, lien protection, equity calls, take control provisions and board observation rights.

*Senior Debt.* We seek to invest a limited portion of our assets in senior debt of prospective portfolio companies. Senior debt has a senior position with respect to a borrower's scheduled interest and principal payments and holds a first priority security interest in the assets pledged as collateral. Senior debt also may impose covenants on a borrower with regard to cash flows and changes in capital structure, among other items. Our senior debt investments carry a contractual interest rate between 8% and 12%, are in an amount between \$1 million and \$5 million with an average initial principal balance of \$2 million, and have an average term of under three years. In some cases we collateralize our investments by obtaining security interests in our portfolio companies' assets, which may include their intellectual property. In other cases we may obtain a negative pledge covering a company's intellectual property. Our senior loans, in certain instances, may be tied to the financing of specific assets. In connection with a senior debt investment, we may also provide the borrower with a working capital line-of-credit that will carry an interest rate ranging from the prime rate to 12%, generally maturing in one year, and will be secured by accounts receivable and / or inventory.

*Equity-Related Securities.* The equity-related securities we hold consist primarily of warrants or other equity interests obtained in connection with our structured mezzanine debt investments. In addition to the warrants received as a part of a structured mezzanine debt financing, we typically receive the right to make equity investments in a portfolio company in connection with the next equity financing round for that company. This right will provide us with the opportunity to further enhance our returns over time through opportunistic equity investments in our portfolio companies. Equity-related investments are typically in the form of preferred or common equity and may be structured with a dividend yield, providing us with a current return, and with customary anti-dilution protection and preemptive rights. In the future, we may achieve liquidity through a merger or acquisition of a portfolio company, a public offering of a portfolio company's stock or by exercising our right, if any, to require a portfolio company to buy back the equity-related securities we hold.

A comparison of the typical features of our various investment alternatives is set forth in the chart below.

	<b>Senior Debt</b>	<b>Structured Mezzanine Debt</b>	<b>Equity Securities</b>
<b>Typical Structure</b>	Term or revolving debt	Term debt with warrants	Preferred stock or common stock
<b>Investment Horizon</b>	Usually under 3 years	Long term, ranging from 2 to 7 years, with an average of 3 years	Long term
<b>Ranking/Security</b>	Senior/First lien	Senior or junior lien	None/unsecured
<b>Covenants</b>	Generally comprehensive	Less restrictive; Mostly financial; Maintenance-based	None
<b>Risk Tolerance</b>	Low	Medium	High
<b>Coupon/Dividend</b>	Cash pay Floating or fixed rate	Cash Pay fixed rate; Payment-in-kind in limited cases	Payment-in kind in limited cases
<b>Customization or Flexibility</b>	Standard	More flexible	Flexible

**Equity Dilution**

None to low

Low

High

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### **Investment Criteria**

We have identified several criteria that we believe will prove important in achieving our investment objective with respect to prospective portfolio companies. These criteria provide general guidelines for our investment decisions.

**Portfolio Composition.** While we focus our investments in venture capital and private equity backed technology-related companies, we seek to diversify across various financial sponsors as well as across various stages of companies' development and various technology industry sub-sectors and geographies.

**Continuing Support from One or More Financial Sponsors.** We generally invest in companies in which one or more established financial sponsors have previously invested and continue to make a contribution to the management of the business. We believe that having established financial sponsors that have meaningful commitments to the business is a key characteristic of a prospective portfolio company. In addition, we look for representatives of one or more financial sponsors to maintain seats on the Board of Directors of a prospective portfolio company as an indication of such commitment.

**Company Stage of Development.** While we invest in companies at various stages of development, we generally require that prospective portfolio companies be beyond the seed stage of development and generally have received or have commitments for their first institutional round of equity financing. We expect a prospective portfolio company to demonstrate its ability to increase its revenues and operating cash flow over time. The anticipated growth rate of a prospective portfolio company is a key factor in determining the value that we ascribe to any warrants or other equity securities that we may acquire in connection with an investment in debt securities.

**Operating Plan.** We generally require that a prospective portfolio company, in addition to having sufficient access to capital to support leverage, demonstrate an operating plan capable of generating cash flows or the ability to raise the additional capital necessary to cover its operating expenses and service its debt. Specifically, we require that a prospective portfolio company demonstrate at the time of our proposed investment that it has cash on its balance sheet, or is in the process of completing a financing so that it will have cash on its balance sheet, sufficient to support its operations for a minimum of 9 to 18 months.

**Security Interest.** In many instances we generally seek a first priority security interest in all of the portfolio company's tangible and intangible assets as collateral for our debt investment, subject in some cases to permitted exceptions. In some cases we may only obtain a negative pledge covering a company's intellectual property. Although we do not intend to operate as an asset-based lender, the estimated liquidation value of the assets, if any, collateralizing the debt securities that we hold is an important factor in our credit analysis. We evaluate both tangible assets, such as accounts receivable, inventory and equipment, and intangible assets, such as intellectual property, customer lists, networks and databases.

**Covenants.** Our investments typically include cross-default and material adverse change provisions, require the portfolio company to provide periodic financial reports and operating metrics and will typically limit the portfolio company's ability to incur additional debt, sell assets, engage in transactions with affiliates and consummate an extraordinary transaction, such as a merger or recapitalization without our consent. In addition, we may require other performance or financial based covenants, as we deem appropriate.

**Exit Strategy.** Prior to making a debt investment that is accompanied by an equity-related security in a prospective portfolio company, we analyze the potential for that company to increase the liquidity of its equity through a future event that would enable us to realize appreciation in



the value of our equity interest. Liquidity events may include an initial public offering, a private sale of our equity interest to a third party, a merger or an acquisition of the company or a purchase of our equity position by the company or one of its stockholders.

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**Investment Process**

We have organized our management team around the four key elements of our investment process:

Origination;

Underwriting;

Documentation; and

Loan and Compliance Administration.

Our investment process is summarized in the following chart:

**Origination**

The origination process for our investments includes sourcing, screening, preliminary due diligence and deal structuring and negotiation, all leading to an executed non-binding term sheet. Our investment origination team, which consists of nine professionals headed by our Chief Executive Officer, Mr. Henriquez, will be responsible for sourcing potential investment opportunities. The origination team utilizes their extensive relationships with various leading financial sponsors, management contacts within technology-related companies, trade sources, technology conferences and various publications to source prospective portfolio companies.

In addition, we have developed a proprietary and comprehensive SQL-based database system to track various aspects of our investment process including sourcing, originations, transaction monitoring and post-investment performance. As of December 31, 2005, our proprietary SQL-based database system included over 7,900 technology-related companies and over 1,480 venture capital private equity sponsors/investors, as well as various other industry contacts. This proprietary SQL system allows our origination team to maintain, cultivate and grow our industry relationships while providing our origination team with comprehensive details on companies in the technology-related industries and their financial sponsors.

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If a prospective portfolio company generally meets certain underwriting criteria, we perform preliminary due diligence, which may include high level company and technology assessments, evaluation of its financial sponsors' support, market analysis, competitive analysis, evaluation of select management, risk analysis and transaction size, pricing, return analysis and structure analysis. If the preliminary due diligence is satisfactory, and the origination team recommends moving forward, we then structure, negotiate and execute a non-binding term sheet with the potential portfolio company. Upon execution of a term sheet, the investment opportunity moves to the underwriting process to complete formal due diligence review and approval.

## **Underwriting**

The underwriting review includes formal due diligence and approval of the proposed investment in the portfolio company.

*Due Diligence.* Our due diligence on a prospective investment is typically completed by two or more investment professionals which we define as the underwriting team. The underwriting team for a proposed investment consists of the deal sponsor who possesses specific industry knowledge and is responsible for originating and managing the transaction, other investment professional(s) who perform due diligence, credit and corporate financial analyses and, as needed, our Chief Legal Officer. To ensure consistent underwriting, we use our standardized due diligence methodologies, which include due diligence on financial performance and credit risk as well as an analysis of the operations, accounting policies and the legal and regulatory framework of a prospective portfolio company. The members of the underwriting team work together to conduct due diligence and understand the relationships among the prospective portfolio company's business plan, operations and financial performance.

As part of our evaluation of a proposed investment, the underwriting team prepares an investment memorandum for presentation to the investment committee. In preparing the investment memorandum, the underwriting team typically meets with key management of the company and selects its financial sponsors and assembles information critical to the investment decision. If and when appropriate, the investment professionals may also contact industry experts and customers, vendors or, in some cases, competitors of the company.

*Approval Process.* The sponsoring managing director or principal presents the investment memorandum to our investment committee for consideration. The unanimous approval of our investment committee is required before we proceed with any investment. The members of our investment committee are our Chief Executive Officer, our Senior Managing Director, our Chief Legal Officer and our Vice President of Finance. The investment committee generally meets weekly and more frequently on an as-needed basis.

## **Documentation**

Our documentation group, headed by our Chief Legal Officer, administers the front-end documentation process for our loans. This group is responsible for documenting the term sheet approved by the investment committee to memorialize the transaction with a portfolio company. This group negotiates loan documentation and, subject to the approval of the Chief Legal Officer, final documents are prepared for execution by all parties. The documentation group generally uses the services of external law firms to complete the necessary documentation.

## **Loan and Compliance Administration**

Our loan and compliance administration group, headed by our Vice President of Finance, administers loans and tracks covenant compliance on our investments and oversees periodic reviews of our critical functions to ensure adherence with our internal policies and procedures. After funding of a loan in accordance with the investment committee's approval, the loan is recorded in our SQL-based database system. The loan and compliance administration group is also responsible for ensuring timely interest and principal payments and

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collateral management and advises the investment committee on the financial performance and trends of each portfolio company, including any covenant violations that occur, to aid us in assessing the appropriate course of action for each portfolio company and evaluating overall portfolio quality. In addition, the loan and compliance administration group advises the Valuation Committee of the board regarding the credit and investment grading for each portfolio company as well as changes in the value of collateral that may occur.

The loan and compliance administration group monitors our portfolio companies in order to determine whether the companies are meeting our financing criteria and their respective business plans and also monitors the financial trends of each portfolio company from its monthly or quarterly financial statements to assess the appropriate course of action for each company and to evaluate overall portfolio quality. In addition, our management team closely monitors the status and performance of each individual company through our SQL-based database system and periodic contact with our portfolio companies' management teams and their respective financial sponsors.

*Credit and Investment Grading System.* Our loan and compliance administration group uses an investment grading system to characterize and monitor our expected level of returns on both the debt investments and the related warrants or equity positions for each investment in our portfolio. Our loan and compliance administration group monitors and, when appropriate, recommends changes to investment grading. Our investment committee reviews the recommendations and/or changes to the investment grading, which are submitted on a quarterly basis to the Valuation Committee and our Board of Directors for approval. We use the following investment grading system as amended January 2006 and approved by our Board of Directors:

- 1 Loans involve the least amount of risk in our portfolio. The borrower is performing above expectations, and the trends and risk profile is generally favorable.
- 2 The borrower is performing as expected and the risk profile is neutral to favorable. All new loans are initially graded 2.
- 3 The borrower may be performing below expectations and that the loan's risk has increased materially since origination. We increase procedures to monitor a borrower that may have limited amounts of cash remaining on the balance sheet, is approaching its next equity capital raise within the next three to six months, or if the estimated fair value of the enterprise may be lower than when the loan was originated. We will generally lower the loan grade to a level 3 even if the company is performing in accordance to plan as it approaches the need to raise additional cash to fund its operations. Once the borrower closes its new equity capital raise, we may increase the loan grade back to grade 2.
- 4 The borrower is performing materially below expectations and that the loan risk has substantially increased since origination. Loans graded 4 may experience some partial loss or full return of principal but are expected to realize some loss of interest which is not anticipated to be repaid in full, which, to the extent not already reflected, may require the fair value of the loan to be reduced to the amount we anticipate will be recovered. Grade 4 investments are closely being monitored.
- 5 The borrower is in workout, materially performing below expectations and significant risk of principal loss is probable. Loans graded 5 will experience some partial principal loss or full loss of remaining principal outstanding is expected. Grade 5 loans will require the fair value of the loans be reduced to the amount we anticipate, if any, will be recovered.

As of December 31, 2005, our investments had a weighted average investment rating of 2.05.

### **Managerial Assistance**

As a business development company, we offer, and provide upon request, managerial assistance to our portfolio companies. This assistance could involve, among other things, monitoring the operations of our portfolio companies, participating in board and management meetings, consulting with and advising officers of portfolio companies and providing other organizational and financial guidance. We may receive fees for these services.

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### **Competition**

Our primary competitors provide financing to prospective portfolio companies and include financial institutions, venture capital funds, private equity funds, investment funds and investment banks. Many of these entities have greater financial and managerial resources than we have, and the 1940 Act imposes certain regulatory restrictions on us as a business development company to which many of our competitors are not subject. However, we believe that few of our competitors possess the expertise to properly structure and price debt investments to venture capital and private equity backed technology-related companies. We believe that our specialization in financing technology-related companies will enable us to assess the value of intellectual property assets, evaluate the business prospects and operating characteristics of prospective portfolio companies and, as a result, identify investment opportunities that produce attractive risk-adjusted returns. For additional information concerning the competitive risks we face, see Risk Factors Risks Related to our Business and Structure. We operate in a highly competitive market for investment opportunities, and we may not be able to compete effectively.

### **Corporate Structure**

We are a Maryland corporation and an internally-managed, non-diversified closed-end investment company that has elected to be regulated as a business development company under the 1940 Act. Hercules Technology II, L.P., our wholly-owned subsidiary, has applied to be licensed under the Small Business Investment Act of 1958 as a Small Business Investment Company. See Regulation below for further information about small business investment company regulation. Hercules Technology SBIC Management, LLC, another wholly-owned subsidiary, functions as the general partner of our subsidiary Hercules Technology II, L.P. Hercules Funding I LLC, our wholly owned subsidiary, and Hercules Funding Trust I function as vehicles to collateralize loans under our securitized credit facility with Citigroup Global Markets Realty Corp.

Our principal executive offices are located at 525 University Avenue, Suite 700, Palo Alto, California 94301. We also have offices in Boston, Massachusetts, Boulder, Colorado and Chicago, Illinois.

### **Employees**

As of December 31, 2005, we had 19 employees, including 12 investment and portfolio management professionals, operations professionals and legal counsel, all of whom have extensive prior experience working on financing transactions for technology-related companies. We intend to hire additional professionals with business lending experience as well as additional administrative personnel, and we expect to expand our management team and hire additional Managing Directors.

### **Legal Proceedings**

Hercules Technology Growth Capital, Inc. is not a party to any pending legal proceedings.

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The following tables set forth certain information as of December 31, 2005 regarding each portfolio company in which we had a debt or equity investment. The general terms of our loans and other investments are described in Business Our Investments. We offer to make available significant managerial assistance to our portfolio companies. In addition, we may receive rights to observe the Board of Directors meetings of our portfolio companies.

**Investments at December 31, 2005**

<b>Name and Address of Portfolio Company</b>	<b>Nature of its Principal Business</b>	<b>Title of Securities held by Us</b>	<b>Percentage of Class Held<sup>(1)</sup></b>	<b>Cost of Investment<sup>(2)</sup></b>	<b>Fair Value of Investment<sup>(3)(4)</sup></b>
Acceleron Pharmaceuticals, Inc. 24 Emily Street Cambridge, Massachusetts 02139	Biopharmaceuticals	Senior Debt	100%	\$ 3,932,539	\$ 3,932,539
		Preferred Stock Warrants	100%	69,106	68,054
				4,001,645	4,000,593
Adiana, Inc. 2684 Middlefield Rd. Redwood City, California 94063	Medical devices & equipment	Senior Debt	100%	1,943,979	
		Preferred Stock Warrants	100%	67,225	1,943,979
		Preferred Stock	<5%	500,000	66,404
				500,000	500,000
				2,511,204	2,510,383
Affinity Express, Inc. 630 Tollgate Road, Suite E Elgin, Illinois 60123	Internet consumer & business services	Senior Debt	100%	1,560,450	1,560,450
		Common Stock Warrants	100%	17,000	187,922
		Common Stock Warrants	100%	15,000	12,995
		Preferred Stock		250,000	250,000
				1,842,450	2,011,367
Ageia Technologies 82 Pioneer Way Mountain View, California 94041	Semiconductors	Senior Debt	100%	7,914,586	7,914,586
		Preferred Stock Warrants	100%	99,190	93,518
		Preferred Stock		500,000	500,000
				8,513,776	8,508,104
Atrenta, Inc. 2001 Gateway Place, Suite 440W San Jose, California 95110	Software	Senior Debt	100%	4,869,095	4,869,095
		Preferred Stock Warrants	100%	102,396	102,886
		Preferred Stock Warrants	100%	33,760	33,760
				5,005,251	5,005,741
Concuity, Inc.	Software				



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22320 Foothill Blvd., Suite 500		Senior Debt	100%	4,567,873	4,567,873
Hayward, California 94541		Preferred Stock Warrants	100%	3,500	3,500
				4,571,373	4,567,873
Cornice, Inc.	Electronics & computer hardware	Senior Debt	100%	4,915,455	4,915,455
1951 S. Fordham Street		Revolving Line of Credit	100%	7,663,375	7,663,375
Building 105		Preferred Stock Warrants	100%	101,597	99,336
Longmont, CO 80503		Preferred Stock Warrants	100%	35,353	34,230
		Preferred Stock Warrants	100%	135,403	132,390
				12,851,183	12,844,786
Cradle Technologies	Semiconductors	Senior Debt	100%	1,923,049	1,923,049
1197 Borregas Avenue		Preferred Stock Warrants	100%	79,150	78,730
Sunnyvale, California 94089				2,002,199	