
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

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

For The Quarterly Period Ended March 31, 2006

OR

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

Commission File Number: 814-00702

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Maryland
(State or Jurisdiction of
Incorporation or Organization)

743113410
(IRS Employer
Identification No.)

525 University Ave., Suite 700
Palo Alto, California 94301
(Address of Principal Executive Offices)

94301
(Zip Code)

(650) 289-3060
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods as the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) YES NO

On May 7, 2006, there were 13,646,857 shares outstanding of the Registrant's common stock, \$0.001 par value.

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
FORM 10-Q TABLE OF CONTENTS

| | | |
|-----------------|---|----|
| PART I. | FINANCIAL INFORMATION | 2 |
| Item 1. | Consolidated Financial Statements | 2 |
| | Consolidated Statements of Assets and Liabilities as of March 31, 2006 (unaudited) and December 31, 2005 | 2 |
| | Consolidated Schedule of Investments as of March 31, 2006 (unaudited) | 3 |
| | Consolidated Schedule of Investments as of December 31, 2005 | 8 |
| | Consolidated Statements of Operations for the three-month period ended March 31, 2006 and 2005 (unaudited) | 12 |
| | Consolidated Statements of Changes in Net Assets for the three-month period ended March 31, 2006 and 2005 (unaudited) | 13 |
| | Consolidated Statements of Cash Flows for the three-month period ended March 31, 2006 and 2005 (unaudited) | 14 |
| | Notes to Consolidated Financial Statements (unaudited) | 15 |
| Item 2. | Management’s Discussion and Analysis of Financial Condition and Results of Operations | 23 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 33 |
| Item 4. | Controls and Procedures | 35 |
| PART II. | OTHER INFORMATION | 36 |
| Item 1. | Legal Proceedings | 36 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 36 |
| Item 3. | Defaults Upon Senior Securities | 36 |
| Item 4. | Submission of Matters to a Vote of Security Holders | 36 |
| Item 5. | Other Information | 36 |
| Item 6. | Exhibits | 36 |
| | Signatures | 37 |

[Table of Contents](#)

PART I: FINANCIAL INFORMATION

In this Quarterly Report, the “Company”, “Hercules”, “we”, “us” and “our” refer to Hercules Technology Growth Capital, Inc. and its wholly owned subsidiaries and its affiliated securitization trusts unless the context otherwise requires.

ITEM 1. FINANCIAL STATEMENTS

**HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES**

| | March 31, 2006 (unaudited) | December 31, 2005 |
|--|----------------------------------|-----------------------|
| Assets | | |
| Investments, at value (cost of \$172,159,286 and \$176,004,865, respectively) | \$ 176,800,736 | \$ 176,673,226 |
| Deferred loan origination revenue | (2,975,660) | (2,729,982) |
| Cash and cash equivalents | 31,554,481 | 15,362,447 |
| Interest receivable | 1,758,701 | 1,479,375 |
| Prepaid expenses | 1,165,487 | 1,310,594 |
| Deferred tax asset | 181,000 | 1,454,000 |
| Property and equipment, net | 71,019 | 77,673 |
| Other assets | 20,546 | 20,546 |
| Total assets | 208,576,310 | 193,647,879 |
| Liabilities | | |
| Accounts payable | 582,103 | 150,081 |
| Income tax payable | 421,000 | 1,709,000 |
| Accrued liabilities | 2,533,472 | 1,436,468 |
| Short-term loans payable | 86,000,000 | 76,000,000 |
| Total liabilities | 89,536,575 | 79,295,549 |
| Net assets | \$ 119,039,735 | \$ 114,352,330 |
| Net assets consist of: | | |
| Par value | \$ 10,235 | \$ 9,802 |
| Paid-in capital in excess of par value | 119,647,400 | 114,524,833 |
| Distributable earnings (accumulated loss) | (617,900) | (182,305) |
| Total net assets | \$ 119,039,735 | \$ 114,352,330 |
| Shares of common stock outstanding (\$0.001 par value, 30,000,000 authorized) | 10,234,865 | 9,801,965 |
| Net asset value per share | \$ 11.63 | \$ 11.67 |

See notes to consolidated financial statements (unaudited).

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2006
(unaudited)

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|--|--------------------|--|------------------|---------------------|-------------------------|
| Acceleron Pharmaceuticals, Inc. (3.36%)* | Biopharmaceuticals | Senior Debt Matures June 2009 Interest rate 10.25% | \$ 4,000,000 | \$ 3,937,476 | \$ 3,937,476 |
| | | Preferred Stock Warrants | | 69,106 | 66,722 |
| Total Acceleron Pharmaceuticals, Inc. | | | | 4,006,582 | 4,004,198 |
| Aveo Pharmaceuticals, Inc. (6.30%) | Biopharmaceuticals | Senior Debt Matures September 2009 Interest rate 10.50% | \$ 7,500,000 | 7,500,000 | 7,500,000 |
| | | Preferred Stock Warrants | | — | — |
| Total Aveo Pharmaceuticals, Inc. | | | | 7,500,000 | 7,500,000 |
| Guava Technologies, Inc. (3.79%) | Biopharmaceuticals | Senior Debt Matures July 2009 Interest rate Prime + 3.25% | \$ 4,500,000 | 4,404,639 | 4,404,639 |
| | | Preferred Stock Warrants | | 105,399 | 101,804 |
| Total Guava Technologies, Inc. | | | | 4,510,038 | 4,506,443 |
| Labopharm USA, Inc. (7.81%) | Biopharmaceuticals | Senior Debt Matures July 2008 Interest rate 11.95% | \$ 9,255,041 | 9,300,069 | 9,300,069 |
| Total Labopharm USA, Inc. | | | | 9,300,069 | 9,300,069 |
| Merrimack Pharmaceuticals, Inc. (7.24%) | Biopharmaceuticals | Senior Debt Matures October 2008 Interest rate 11.15% | \$ 8,288,546 | 8,178,589 | 8,178,589 |
| | | Preferred Stock Warrants | | 155,456 | 438,664 |
| Total Merrimack Pharmaceuticals, Inc. | | | | 8,334,045 | 8,617,253 |
| Omrix Biopharmaceuticals, Inc. (3.62%) | Biopharmaceuticals | Senior Debt Matures March 2008 Interest rate 11.45% | \$ 4,262,288 | 4,255,024 | 4,255,024 |
| | | Common Stock Warrants | | 11,370 | 54,992 |
| Total Omrix Biopharmaceuticals, Inc. | | | | 4,266,394 | 4,310,016 |
| Paratek Pharmaceuticals, Inc. (7.94%) | Biopharmaceuticals | Senior Debt Matures June 2008 Interest rate 10.60% | \$ 9,411,475 | 9,312,245 | 9,312,245 |
| | | Preferred Stock Warrants | | 137,396 | 138,245 |
| Total Paratek Pharmaceuticals, Inc.⁽⁵⁾ | | | | 9,449,641 | 9,450,490 |
| Quatrx Pharmaceuticals Company (5.05%) | Biopharmaceuticals | Senior Debt Matures January 2010 Interest rate Prime + 3.00% | \$ 6,000,000 | 5,793,418 | 5,793,418 |
| | | Preferred Stock Warrants | | 220,354 | 216,639 |
| Total Quatrx Pharmaceuticals Company | | | | 6,013,772 | 6,010,057 |
| Total Biopharmaceuticals (45.11%) | | | | 53,380,541 | 53,698,526 |
| Atrenta, Inc. (4.21%) | Software | Senior Debt Matures June 2009 Interest rate 11.50% | \$ 5,000,000 | 4,884,849 | 4,884,849 |
| | | Preferred Stock Warrants | | 102,396 | 100,899 |
| | | Preferred Stock Warrants | | 33,760 | 33,108 |
| Total Atrenta, Inc. | | | | 5,021,005 | 5,018,856 |
| Compete, Inc. (3.36%) | Software | Senior Debt Matures March 2009 Interest rate Prime + 3.50% | \$ 4,000,000 | 3,939,610 | 3,939,610 |
| | | Preferred Stock Warrants | | 62,067 | 58,969 |
| Total Compete, Inc. | | | | 4,001,677 | 3,998,579 |

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2006
(Continued)

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|---|------------------------------|---|------------------|---------------------|-------------------------|
| Concuity, Inc. (3.47%) | Software | Senior Debt Matures March 2008 Interest rate 9.95% | \$ 4,129,022 | \$ 4,126,688 | \$ 4,126,688 |
| | | Preferred Stock Warrants | | 3,500 | — |
| Total Concuity, Inc. | | | | 4,130,188 | 4,126,688 |
| Gomez, Inc. (1.66%) | Software | Senior Debt Matures December 2007 Interest rate 12.25% | \$ 1,961,705 | 1,942,261 | 1,942,261 |
| | | Preferred Stock Warrants | | 35,000 | 30,172 |
| Total Gomez, Inc. | | | | 1,977,261 | 1,972,433 |
| HighRoads, Inc. (1.20%) | Software | Senior Debt Matures February 2009 Interest rate 11.25% | \$ 1,421,884 | 1,379,888 | 1,379,888 |
| | | Preferred Stock Warrants | | 44,466 | 42,642 |
| Total HighRoads, Inc. | | | | 1,424,354 | 1,422,530 |
| Inxight Software, Inc. (4.20%) | Software | Senior Debt Matures February 2008 Interest rate 10.00% | \$ 5,000,000 | 4,961,525 | 4,961,525 |
| | | Preferred Stock Warrants | | 55,963 | 44,008 |
| Total Inxight Software, Inc. | | | | 5,017,488 | 5,005,533 |
| Proficiency, Inc. (2.54%) | Software | Senior Debt Matures July 2008 Interest rate 12.00% | \$ 3,000,000 | 3,926,305 | 3,018,184 |
| | | Preferred Stock Warrants | | 96,370 | — |
| Total Proficiency, Inc. | | | | 4,022,675 | 3,018,184 |
| Savvion, Inc. (1.68%) | Software | Revolving Line of Credit Matures March 2007 Interest rate Prime + 2.00% | \$ 2,000,000 | 1,952,210 | 1,952,210 |
| | | Preferred Stock Warrants | | 52,135 | 49,836 |
| Total Savvion, Inc. | | | | 2,004,345 | 2,002,046 |
| Sportvision, Inc. (2.70%) | Software | Senior Debt Matures June 2008 Interest rate 9.95% | \$ 3,218,414 | 3,191,095 | 3,191,095 |
| | | Preferred Stock Warrants | | 39,339 | 37,446 |
| Total Sportvision, Inc. | | | | 3,230,434 | 3,228,541 |
| Talisma Corp. (2.57%) | Software | Subordinated Debt Matures December 2007 Interest rate 11.25% | \$ 3,041,916 | 3,014,694 | 3,014,694 |
| | | Preferred Stock Warrants | | 49,000 | 40,371 |
| Total Talisma Corp. | | | | 3,063,694 | 3,055,065 |
| Total Software (27.59%) | | | | 33,893,121 | 32,848,455 |
| Market Force Information, Inc. (1.68%) | Consumer & Business Products | Subordinated Debt Matures May 2009 Interest rate 10.45% | \$ 2,000,000 | 1,976,804 | 1,976,804 |
| | | Preferred Stock Warrants | | 23,823 | 22,968 |
| Total Market Force Information, Inc. | | | | 2,000,627 | 1,999,772 |

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2006
(Continued)

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|--|------------------------------|--|------------------|---------------------|-------------------------|
| Wageworks, Inc. (15.53%) | Consumer & Business Products | Senior Debt Matures November 2008 Interest rate Prime + 4.00% | \$ 17,481,121 | \$ 17,295,148 | \$ 17,295,148 |
| | | Preferred Stock Warrants | | 251,964 | 1,190,983 |
| Wageworks, Inc. (0.21%) | | Preferred Stock | | 249,995 | 249,995 |
| Total Wageworks, Inc. | | | | 17,797,107 | 18,736,126 |
| Total Consumer & Business Products (17.42%) | | | | 19,797,734 | 20,735,898 |
| IKANO Communications, Inc. (0.09%) | Communications & Networking | Preferred Stock Warrants | | 45,460 | 42,449 |
| | | Preferred Stock Warrants | | 72,344 | 69,223 |
| Total IKANO Communications, Inc. | | | | 117,804 | 111,672 |
| Interwise, Inc. (2.22%) | Communications & Networking | Senior Debt Matures August 2008 Interest rate 17.50% | \$ 2,641,082 | 2,641,082 | 2,641,082 |
| Total Interwise, Inc. | | | | 2,641,082 | 2,641,082 |
| Occam Networks, Inc. (1.16%) | Communications & Networking | Preferred Stock Warrants | | 14,000 | 610,723 |
| | | Common Stock Warrants | | 17,000 | 771,213 |
| Total Occam Networks, Inc. | | | | 31,000 | 1,381,936 |
| Optovia Corporation (4.20%) | Communications & Networking | Senior Debt Matures September 2006 Interest rate Prime + 7.25% | \$ 5,000,000 | 5,000,000 | 5,000,000 |
| Total Optovia Corporation | | | | 5,000,000 | 5,000,000 |
| Pathfire, Inc. (4.21%) | Communications & Networking | Senior Debt Matures December 2008 Interest rate Prime + 3.65% | \$ 5,000,000 | 4,943,755 | 4,943,755 |
| | | Preferred Stock Warrants | | 63,276 | 62,899 |
| Total Pathfire, Inc. | | | | 5,007,031 | 5,006,654 |
| Ping Identity Corporation (1.26%) | Communications & Networking | Senior Debt Matures June 2009 Interest rate 11.25% | \$ 1,500,000 | 1,449,562 | 1,449,562 |
| | | Preferred Stock Warrants | | 51,801 | 49,076 |
| Total Ping Identity Corporation | | | | 1,501,363 | 1,498,638 |
| Simpler Networks Corp. (4.72%) | Communications & Networking | Senior Debt Matures July 2009 Interest rate 11.75% | \$ 5,000,000 | 4,851,484 | 4,851,484 |
| | | Preferred Stock Warrants | | 160,241 | 769,984 |
| Total Simpler Networks Corp. | | | | 5,011,725 | 5,621,468 |
| Total Communications & Networking (17.86%) | | | | 19,310,005 | 21,261,450 |
| Adiana, Inc. (1.60%) | Medical Devices & Equipment | Senior Debt Matures June 2008 Interest rate Prime + 6.00% | \$ 1,885,272 | 1,834,853 | 1,834,853 |
| | | Preferred Stock Warrants | | 67,225 | 64,846 |
| Adiana, Inc. (0.42%) | | Preferred Stock | | 500,000 | 500,000 |
| Total Adiana, Inc. | | | | 2,402,078 | 2,399,699 |
| Gynesonics, Inc. (0.01%) | Medical Devices & Equipment | Senior Debt Matures October 2009 Interest rate Prime + 1.25% | | — | — |
| | | Preferred Stock Warrants | | 17,552 | 16,699 |
| Total Gynesonics, Inc. | | | | 17,552 | 16,699 |

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2006
(Continued)

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|--|---------------------------------------|--|------------------|---------------------|-------------------------|
| Optiscan Biomedical, Corp. (1.35%) | Medical Devices & Equipment | Senior Convertible Term Loan Matures March 2008 Interest rate 15.00% | \$ 1,590,651 | \$ 1,528,339 | \$ 1,528,339 |
| | | Preferred Stock Warrants | | 80,486 | 79,360 |
| | | Preferred Stock | | 1,000,000 | 1,000,000 |
| Total Optiscan Biomedical, Corp. | | | | 2,608,825 | 2,607,699 |
| Power Medical Interventions, Inc. (3.09%) | Medical Devices & Equipment | Senior Debt Matures June 2008 Interest rate 10.71% | \$ 3,646,253 | 3,619,034 | 3,619,034 |
| | | Common Stock Warrants | | 39,195 | 55,426 |
| Total Power Medical Interventions, Inc. | | | | 3,658,229 | 3,674,460 |
| Killix Technologies Corp. (4.72%) | Medical Devices & Equipment | Senior Debt Matures December 2008 Interest rate 12.40% | \$ 5,500,000 | 5,221,682 | 5,221,682 |
| | | Preferred Stock Warrants | | 313,108 | 400,831 |
| Total Killix Technologies Corp. | | | | 5,534,790 | 5,622,513 |
| Total Medical Devices & Equipment (12.03%) | | | | 14,221,474 | 14,321,070 |
| Affinity Express, Inc. (1.42%) | Internet Consumer & Business Services | Senior Debt Matures November 2007 Interest rate 13.50% | \$ 1,452,561 | 1,432,627 | 1,432,627 |
| | | Common Stock Warrants | | 17,000 | 186,624 |
| | | Common Stock Warrants | | 15,000 | 55,924 |
| | | Preferred Stock | | 250,000 | 250,000 |
| Total Affinity Express, Inc. | | | | 1,714,627 | 1,925,175 |
| Hedgestreet, Inc. (0.05%) | Internet Consumer & Business Services | Senior Debt Matures March 2009 Interest rate Prime + 3.25% | | 4,456 | 4,456 |
| | | Preferred Stock Warrants | | 54,956 | 54,023 |
| Total Hedgestreet, Inc. | | | | 59,412 | 58,479 |
| Invoke Solutions, Inc. (2.52%) | Internet Consumer & Business Services | Senior Debt Matures December 2008 Interest rate 11.25% | \$ 3,000,000 | 2,961,044 | 2,961,044 |
| | | Preferred Stock Warrants | | 43,826 | 43,301 |
| Total Total Invoke Solutions, Inc. | | | | 3,004,870 | 3,004,345 |
| RazorGator Interactive Group, Inc. (3.66%) | Internet Consumer & Business Services | Senior Debt Matures January 2008 Interest rate 9.95% | \$ 3,778,710 | 3,771,098 | 3,771,098 |
| | | Preferred Stock Warrants | | 13,050 | 591,652 |
| RazorGator Interactive Group, Inc. (1.43%) | | Preferred Stock | | 1,000,000 | 1,708,178 |
| Total RazorGator Interactive Group, Inc. | | | | 4,784,148 | 6,070,928 |
| Total Internet Consumer & Business Services (9.29%) | | | | 9,563,057 | 11,058,927 |
| Cornice, Inc. (7.91%) | Electronics & Computer Hardware | Senior Debt Matures November 2008 Interest rate Prime + 4.50% | \$ 4,509,072 | 4,475,682 | 4,475,682 |
| | | Revolving Line of Credit Matures November 2006 Interest rate Prime + 3.00% | \$ 4,843,363 | 4,672,607 | 4,672,607 |
| | | Preferred Stock Warrants | | 101,597 | 97,368 |
| | | Preferred Stock Warrants | | 35,353 | 33,540 |
| | | Preferred Stock Warrants | | 135,403 | 129,767 |
| Total Cornice, Inc. | | | | 9,420,642 | 9,408,964 |

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
March 31, 2006
(Continued)

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|--|---------------------------------|-----------------------------------|------------------|-----------------------|-------------------------|
| Sling Media, Inc. (1.21%) | Electronics & Computer Hardware | Preferred Stock Warrants | | \$ 38,968 | \$ 944,328 |
| | | Preferred Stock | | 500,000 | 500,000 |
| Total Sling Media, Inc. | | | | 538,968 | 1,444,328 |
| Total Electronics & Computer Hardware (9.12%) | | | | 9,959,610 | 10,853,292 |
| Ageia Technologies (6.73%) | Semiconductors | Senior Debt | | | |
| | | Matures August 2008 | | | |
| | | Interest rate 10.25% | \$ 8,000,000 | 7,922,852 | 7,922,852 |
| | | Preferred Stock Warrants | | 99,190 | 91,272 |
| Ageia Technologies (0.42%) | | Preferred Stock | | 500,000 | 500,000 |
| Total Ageia Technologies | | | | 8,522,042 | 8,514,124 |
| Cradle Technologies (1.69%) | Semiconductors | Senior Debt | | | |
| | | Matures December 2008 | | | |
| | | Interest rate Prime + 4.70% | \$ 2,000,000 | 1,929,644 | 1,929,644 |
| | | Preferred Stock Warrants | | 79,150 | 77,190 |
| Total Cradle Technologies | | | | 2,008,794 | 2,006,834 |
| Total Semiconductors (8.84%) | | | | 10,530,836 | 10,520,958 |
| Lilliputian Systems, Inc. (1.26%) | Energy | Senior Debt | | | |
| | | Matures March 2010 | | | |
| | | Interest rate 9.75% | \$ 1,500,000 | 1,454,448 | 1,454,448 |
| | | Preferred Stock Warrants | | 48,460 | 47,712 |
| Total Lilliputian Systems, Inc. | | | | 1,502,908 | 1,502,160 |
| Total Energy (1.26%) | | | | 1,502,908 | 1,502,160 |
| Total Investments (148.52%) | | | | \$ 172,159,286 | \$ 176,800,736 |

* Value as a percent of net assets

- (1) All debt investments are income producing. Preferred stock and all warrants are non-income producing.
- (2) Tax cost at March 31, 2006 equals book cost. Gross unrealized appreciation, gross unrealized depreciation, and net appreciation totaled \$5,734,019, \$1,092,569 and \$4,641,450, respectively.
- (3) All investments are restricted at March 31, 2006 and were valued at fair value as determined in good faith by the Board of Directors. No unrestricted securities of the same issuer are outstanding. The Company uses the Standard Industrial Code for classifying the industry grouping of its portfolio companies.
- (4) Citigroup has an equity participation right on loans collateralized under the Citigroup facility (see Note 4). The value of their participation right on unrealized gains in the related equity investments was approximately \$366,000 at March 31, 2006 and is included in accrued liabilities. For the quarter ended March 31, 2006, realized and unrealized gains were reduced by approximately \$136,000 and \$159,000, respectively, for the participation rights.
- (5) Paratek recently completed a strategic collaboration and financing for which no valuation change was recognized at March 31, 2006.

See notes to consolidated financial statements (unaudited).

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
DECEMBER 31, 2005

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|--|--------------------|---|------------------|---------------------|-------------------------|
| Acceleron Pharmaceuticals, Inc. (3.50%)* | Biopharmaceuticals | Senior Debt Matures June 2009 Interest rate 10.25% | \$ 4,000,000 | \$ 3,932,539 | \$ 3,932,539 |
| | | Preferred Stock Warrants | | 69,106 | 68,054 |
| Total Acceleron Pharmaceuticals, Inc. | | | | 4,001,645 | 4,000,593 |
| Guava Technologies, Inc. (3.94%) | Biopharmaceuticals | Senior Debt Matures July 2009 Interest rate Prime + 3.25% | \$ 4,500,000 | 4,397,111 | 4,397,111 |
| | | Preferred Stock Warrants | | 105,399 | 103,837 |
| Total Guava Technologies, Inc. | | | | 4,502,510 | 4,500,948 |
| Labopharm USA, Inc. (8.63%) | Biopharmaceuticals | Senior Debt Matures July 2008 Interest rate 11.95% | \$ 9,837,901 | 9,869,420 | 9,869,420 |
| Labopharm USA, Inc. (1.20%) | | Common Stock | | 112,335 | 1,367,268 |
| Total Labopharm USA, Inc. | | | | 9,981,755 | 11,236,688 |
| Merrimack Pharmaceuticals, Inc. (7.89%) | Biopharmaceuticals | Senior Debt Matures October 2008 Interest rate 11.15% | \$ 9,000,000 | 8,878,668 | 8,878,668 |
| | | Preferred Stock Warrants | | 155,456 | 140,675 |
| Total Merrimack Pharmaceuticals, Inc. | | | | 9,034,124 | 9,019,343 |
| Omxix Biopharmaceuticals, Inc. (4.16%) | Biopharmaceuticals | Senior Debt Matures March 2008 Interest rate 11.45% | \$ 4,709,994 | 4,701,782 | 4,701,782 |
| | | Common Stock Warrants | | 11,370 | 58,399 |
| Total Omrix Biopharmaceuticals, Inc. | | | | 4,713,152 | 4,760,181 |
| Paratek Pharmaceuticals, Inc. (8.76%) | Biopharmaceuticals | Senior Debt Matures June 2008 Interest rate 10.6% | \$ 10,000,000 | 9,889,320 | 9,889,320 |
| | | Preferred Stock Warrants | | 137,396 | 141,881 |
| Total Paratek Pharmaceuticals, Inc. | | | | 10,026,716 | 10,031,201 |
| Total Biopharmaceuticals (38.08%) | | | | 42,259,902 | 43,548,954 |
| Atrenta, Inc. (4.38%) | Software | Senior Debt Matures June 2009 Interest rate 11.50% | \$ 5,000,000 | 4,869,095 | 4,869,095 |
| | | Preferred Stock Warrants | | 102,396 | 102,886 |
| | | Preferred Stock Warrants | | 33,760 | 33,760 |
| Total Atrenta, Inc. | | | | 5,005,251 | 5,005,741 |
| Concuity, Inc. (3.99%) | Software | Senior Debt Matures March 2008 Interest rate 9.95% | \$ 4,570,498 | 4,567,873 | 4,567,873 |
| | | Preferred Stock Warrants | | 3,500 | — |
| Total Concuity, Inc. | | | | 4,571,373 | 4,567,873 |
| Gomez, Inc. (1.93%) | Software | Senior Debt Matures December 2007 Interest rate 12.25% | \$ 2,197,436 | 2,175,075 | 2,175,075 |
| | | Preferred Stock Warrants | | 35,000 | 32,467 |
| Total Gomez, Inc. | | | | 2,210,075 | 2,207,542 |
| Inxight Software, Inc. (4.38%) | Software | Senior Debt Matures February 2008 Interest rate 10.00% | \$ 5,000,000 | 4,956,279 | 4,956,279 |
| | | Preferred Stock Warrants | | 55,963 | 46,735 |
| Total Inxight Software, Inc. | | | | 5,012,242 | 5,003,014 |

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
December 31, 2005
(Continued)

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|--|------------------------------|--|------------------|---------------------|-------------------------|
| Metreo, Inc. (1.11%) | Software | Senior Debt Matures November 2007 Interest rate 12.95% | \$ 500,000 | \$ 4,525,714 | \$ 1,266,000 |
| | | Preferred Stock Warrants | | 50,000 | — |
| Total Metreo, Inc. | | | | 4,575,714 | 1,266,000 |
| Proficiency, Inc. (3.51%) | Software | Senior Debt Matures July 2008 Interest rate 12.00% | \$ 4,000,000 | 3,917,802 | 3,917,802 |
| | | Preferred Stock Warrants | | 96,370 | 94,105 |
| Total Proficiency, Inc. | | | | 4,014,172 | 4,011,907 |
| Sportvision, Inc. (3.08%) | Software | Senior Debt Matures June 2008 Interest rate 9.95% | \$ 3,518,716 | 3,488,119 | 3,488,119 |
| | | Preferred Stock Warrants | | 39,339 | 38,523 |
| Total Sportvision, Inc. | | | | 3,527,458 | 3,526,642 |
| Talisma Corp. (2.99%) | Software | Subordinated Debt Matures December 2007 Interest rate 11.25% | \$ 3,410,120 | 3,378,814 | 3,378,814 |
| | | Preferred Stock Warrants | | 49,000 | 43,428 |
| Total Talisma Corp. | | | | 3,427,814 | 3,422,242 |
| Total Software (25.37%) | | | | 32,344,099 | 29,010,961 |
| Wageworks, Inc. (17.12%) | Consumer & Business Products | Senior Debt Matures November 2008 Interest rate Prime + 4.00% | \$ 18,583,966 | 18,379,995 | 18,379,995 |
| | | Preferred Stock Warrants | | 251,964 | 1,197,735 |
| Wageworks, Inc. (0.22%) | | Preferred Stock | | 249,995 | 249,995 |
| Total Wageworks, Inc. | | | | 18,881,954 | 19,827,725 |
| Total Consumer & Business Products (17.34%) | | | | 18,881,954 | 19,827,725 |
| IKANO Communications, Inc. (14.44%) | Communications & Networking | Senior Debt Matures December 2008 Interest rate 9.25% | \$ 16,454,540 | 16,402,789 | 16,402,789 |
| | | Preferred Stock Warrants | | 45,460 | 43,710 |
| | | Preferred Stock Warrants | | 72,344 | 71,000 |
| Total IKANO Communications, Inc. | | | | 16,520,593 | 16,517,499 |
| Interwise, Inc. (2.46%) | Communications & Networking | Senior Debt Matures August 2008 Interest rate 17.50% | \$ 2,809,653 | 2,809,653 | 2,809,653 |
| Total Interwise, Inc. | | | | 2,809,653 | 2,809,653 |
| Occam Networks, Inc. (2.79%) | Communications & Networking | Senior Debt Matures December 2007 Interest rate 11.95% | \$ 2,559,827 | 2,540,021 | 2,540,021 |
| | | Preferred Stock Warrants | | 14,000 | 286,364 |
| | | Common Stock Warrants | | 17,000 | 368,935 |
| Total Occam Networks, Inc. | | | | 2,571,021 | 3,195,320 |
| Optovia Corporation (4.37%) | Communications & Networking | Senior Debt Matures September 2006 Interest rate Prime + 7.25% | \$ 5,000,000 | 5,000,000 | 5,000,000 |
| Total Optovia Corporation | | | | 5,000,000 | 5,000,000 |

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
December 31, 2005
(Continued)

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|---|---------------------------------------|--|------------------|---------------------|-------------------------|
| Pathfire, Inc. (4.38%) | Communications & Networking | Senior Debt Matures December 2008 Interest rate Prime + 3.65% | \$ 5,000,000 | \$ 4,938,482 | \$ 4,938,482 |
| | | Preferred Stock Warrants | | 63,276 | 64,144 |
| Total Pathfire, Inc. | | | | 5,001,758 | 5,002,626 |
| Total Communications & Networking (28.44%) | | | | 31,903,025 | 32,525,098 |
| Adiana, Inc. (1.76%) | Medical Devices & Equipment | Senior Debt Matures June 2008 Interest rate Prime + 6.00% | \$ 2,000,000 | 1,943,979 | 1,943,979 |
| | | Preferred Stock Warrants | | 67,225 | 66,404 |
| Adiana, Inc. (0.44%) | | Preferred Stock | | 500,000 | 500,000 |
| Total Adiana, Inc. | | | | 2,511,204 | 2,510,383 |
| Optiscan Biomedical, Corp. (1.54%) | Medical Devices & Equipment | Senior Convertible Term Loan Matures March 2008 Interest rate 15.00% | \$ 1,753,164 | 1,683,063 | 1,683,063 |
| | | Preferred Stock Warrants | | 80,486 | 81,185 |
| Optiscan Biomedical, Corp. (0.87%) | | Preferred Stock | | 1,000,000 | 1,000,000 |
| Total Optiscan Biomedical, Corp. | | | | 2,763,549 | 2,764,248 |
| Power Medical Interventions, Inc. (3.52%) | Medical Devices & Equipment | Senior Debt Matures June 2008 Interest rate 10.71% | \$ 4,000,000 | 3,969,515 | 3,969,515 |
| | | Common Stock Warrants | | 39,195 | 56,490 |
| Total Power Medical Interventions, Inc. | | | | 4,008,710 | 4,026,005 |
| Xillix Technologies Corp. (4.83%) | Medical Devices & Equipment | Senior Debt Matures December 2008 Interest rate 12.40% | \$ 5,500,000 | 5,195,589 | 5,195,589 |
| | | Preferred Stock Warrants | | 313,108 | 325,601 |
| Total Xillix Technologies Corp. | | | | 5,508,697 | 5,521,190 |
| Total Medical Devices & Equipment (12.96%) | | | | 14,792,160 | 14,821,826 |
| Affinity Express, Inc. (1.54%) | Internet Consumer & Business Services | Senior Debt Matures November 2007 Interest rate 13.50% | \$ 1,583,531 | 1,560,450 | 1,560,450 |
| | | Common Stock Warrants | | 17,000 | 187,922 |
| Affinity Express, Inc. (0.22%) | | Common Stock Warrants | | 15,000 | 12,995 |
| Total Affinity Express, Inc. | | Preferred Stock | | 250,000 | 250,000 |
| | | | | 1,842,450 | 2,011,367 |
| Invoke Solutions, Inc. (1.31%) | Internet Consumer & Business Services | Senior Debt Matures December 2008 Interest rate 11.25% | \$ 1,500,000 | 1,457,391 | 1,457,391 |
| | | Preferred Stock Warrants | | 43,826 | 44,155 |
| Total Total Invoke Solutions, Inc. | | | | 1,501,217 | 1,501,546 |
| RazorGator Interactive Group, Inc. (3.64%) | Internet Consumer & Business Services | Senior Debt Matures January 2008 Interest rate 9.95% | \$ 4,104,553 | 4,095,853 | 4,095,853 |
| | | Preferred Stock Warrants | | 13,050 | 64,833 |
| RazorGator Interactive Group, Inc. (0.87%) | | Preferred Stock | | 1,000,000 | 1,000,000 |
| Total RazorGator Interactive Group, Inc. | | | | 5,108,903 | 5,160,686 |
| Total Internet Consumer & Business Service (7.58%) | | | | 8,452,570 | 8,673,599 |

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS
December 31, 2005
(Continued)

| Portfolio Company | Industry | Type of Investment ⁽¹⁾ | Principal Amount | Cost ⁽²⁾ | Value ⁽³⁾⁽⁴⁾ |
|---|---------------------------------|-----------------------------------|------------------|-----------------------|-------------------------|
| Cornic Inc. (11.24%) | Electronics & Computer Hardware | Senior Debt | | | |
| | | Matures November 2008 | | | |
| | | Interest rate Prime + 4.50% | \$ 5,000,000 | \$ 4,915,455 | \$ 4,915,455 |
| | | Revolving Line of Credit | | | |
| | | Matures November 2006 | | | |
| | | Interest rate Prime + 3.00% | \$ 7,834,131 | 7,663,375 | 7,663,375 |
| | | Preferred Stock Warrants | | 101,597 | 99,336 |
| | | Preferred Stock Warrants | | 35,353 | 34,230 |
| | | Preferred Stock Warrants | | 135,403 | 132,390 |
| Total Cornice, Inc. | | | | 12,851,183 | 12,844,786 |
| Sling Media, Inc. (4.29%) | Electronics & Computer Hardware | Senior Debt | | | |
| | | Matures January 2009 | | | |
| | | Interest rate 10.25% | \$ 4,000,000 | 3,965,029 | 3,965,029 |
| | | Preferred Stock Warrants | | 38,968 | 945,365 |
| Total Sling Media, Inc. | | | | 4,003,997 | 4,910,394 |
| Total Electronics & Computer Hardware (15.53%) | | | | 16,855,180 | 17,755,180 |
| Ageia Technologies (7.00%) | Semiconductor | Senior Debt | | | |
| | | Matures August 2008 | | | |
| | | Interest rate 10.25% | \$ 8,000,000 | 7,914,586 | 7,914,586 |
| | | Preferred Stock Warrants | | 99,190 | 93,518 |
| Ageia Technologies | | Preferred Stock | | 500,000 | 500,000 |
| Total Ageia Technologies | | | | 8,513,776 | 8,508,104 |
| Cradle Technologies (1.75%) | Semiconductors | Senior Debt | | | |
| | | Matures December 2008 | | | |
| | | Interest rate Prime + 4.70% | \$ 2,000,000 | 1,923,049 | 1,923,049 |
| | | Preferred Stock Warrants | | 79,150 | 78,730 |
| Total Cradle Technologies | | | | 2,002,199 | 2,001,779 |
| Total Semiconductors (9.20%) | | | | 10,515,975 | 10,509,883 |
| Total Investments (154.50%) | | | | \$ 176,004,865 | \$ 176,673,226 |

* Value as a percent of net assets

- (1) All debt investments are income producing. Preferred and common stock and all warrants are non-income producing.
- (2) Tax cost at December 31, 2005 equals book cost. Gross unrealized appreciation, gross unrealized depreciation, and net appreciation totaled \$4,035,789, \$3,367,428 and \$668,361, respectively, at December 31, 2005.
- (3) Except for common stock held in Labopharm Biopharmaceuticals, all investments are restricted at December 31, 2005 and were valued at fair value as determined in good faith by the Board of Directors. No unrestricted securities of the same issuer are outstanding. The Company uses the Standard Industrial Code for classifying the industry grouping of its portfolio companies.
- (4) Citigroup has an equity participation right on warrants collateralized under the Citigroup facility. The value of their participation right on unrealized gains in the related equity investments was approximately \$342,000 at December 31, 2005 and is included in accrued.
- (5) All investments are less than 5% owned.

See notes to consolidated financial statements (unaudited).

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

| | Three Months Ended March 31, | |
|--|------------------------------|------------|
| | 2006 | 2005 |
| Investment income: | | |
| Interest | \$ 5,634,539 | \$ 675,604 |
| Fees | 852,594 | 78,369 |
| Total investment income | 6,487,133 | 753,973 |
| Operating expenses: | | |
| Interest | 1,676,982 | — |
| Loan fees | 250,793 | — |
| Compensation and benefits | 1,205,081 | 494,954 |
| General and administrative | 1,185,392 | 202,649 |
| Stock-based compensation | 123,000 | 24,000 |
| Total operating expenses | 4,441,248 | 721,603 |
| Net investment income before provision for income tax expense and investment gains and losses | 2,045,885 | 32,370 |
| Income tax expense | 1,760,000 | — |
| Net investment income | 285,885 | 32,370 |
| Net realized gain on equity investment | 1,545,022 | — |
| Net increase in unrealized appreciation on investments | 674,089 | — |
| Net gain on investments | 2,219,111 | — |
| Net increase in net assets resulting from operations | \$ 2,504,996 | \$ 32,370 |
| Net investment income before provision for income tax expense and investment gains and losses: | | |
| Basic and diluted | \$ 0.21 | \$ 0.01 |
| Change in net assets per common share: | | |
| Basic and diluted | \$ 0.25 | \$ 0.01 |
| Weighted average shares outstanding: | | |
| Basic | 9,912,595 | 2,892,000 |
| Diluted | 9,958,861 | 2,892,000 |

See notes to consolidated financial statements (unaudited).

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
(unaudited)

| | Common Stock | | Paid-In Capital | Distributable earnings (accumulated deficit) | Net Assets |
|--|-------------------|------------------|-----------------------|--|-----------------------|
| | Shares | Par Value | | | |
| Balance at December 31, 2004 | 2,059,270 | \$ 2,059 | \$ 27,117,896 | \$ (2,041,822) | \$ 25,078,133 |
| Issuance of common shares on January 26, 2005 | 268,134 | 268 | 3,870,542 | — | 3,870,810 |
| Issuance of shares in lieu of 5 year warrants | 298,598 | 299 | (299) | — | — |
| Issuance of shares on exercise of 1 year warrants | 1,175,963 | 1,176 | 12,428,744 | — | 12,429,920 |
| Net investment income | — | — | — | 32,370 | 32,370 |
| Stock options granted | — | — | 24,000 | — | 24,000 |
| Balance at March 31, 2005 | <u>3,801,965</u> | <u>\$ 3,802</u> | <u>\$ 43,440,883</u> | <u>\$ (2,009,452)</u> | <u>\$ 41,435,233</u> |
| Balance at December 31, 2005 | 9,801,965 | \$ 9,802 | \$ 114,524,833 | \$ (182,305) | \$ 114,352,330 |
| Issuance of common stock | 432,900 | 433 | 4,999,567 | — | 5,000,000 |
| Stock-based compensation | — | — | 123,000 | — | 123,000 |
| Distribution to shareholders | — | — | — | (2,940,591) | (2,940,591) |
| Increase in net assets from operations: | | | | | |
| Net investment income | — | — | — | 285,885 | — |
| Net realized gain on investments | — | — | — | 1,545,022 | — |
| Net unrealized depreciation on investments | — | — | — | (908,121) | — |
| Net unrealized appreciation on equity investments | — | — | — | (376,629) | — |
| Net unrealized appreciation on warrants | — | — | — | 1,958,839 | — |
| Net increase in net assets resulting from operations | — | — | — | 2,504,996 | 2,504,996 |
| Balance at March 31, 2006 | <u>10,234,865</u> | <u>\$ 10,235</u> | <u>\$ 119,647,400</u> | <u>\$ (617,900)</u> | <u>\$ 119,039,735</u> |

See notes to consolidated financial statements (unaudited).

[Table of Contents](#)

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

| | Three Months Ended March 31, | |
|--|------------------------------|---------------------|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net increase (decrease) in net assets resulting from operations | \$ 2,504,996 | \$ 32,370 |
| Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash used in operating activities: | | |
| Purchase of investments | (33,000,000) | (16,000,000) |
| Principal payments received on investments | 33,921,115 | 140,916 |
| Net unrealized appreciation on investments | (833,504) | — |
| Net unrealized appreciation on investments due to lender | 159,415 | — |
| Net realized gain on sale of equity investment | (1,075,987) | — |
| Accretion of loan discounts | (425,074) | — |
| Accretion of loan exit fees | (163,819) | — |
| Depreciation | 9,598 | 3,764 |
| Stock-based compensation | 123,000 | 24,000 |
| Amortization of deferred loan origination revenue | (608,172) | (14,104) |
| Change in operating assets and liabilities: | | |
| Interest receivable | (115,507) | (102,260) |
| Prepaid expenses and other current assets | 145,107 | (191,353) |
| Deferred tax asset | 1,273,000 | — |
| Accounts payable | 432,022 | 36,340 |
| Income tax payable | (1,288,000) | — |
| Accrued liabilities | 1,000,926 | — |
| Deferred loan origination revenue | 853,850 | 351,630 |
| Net cash used in operating activities | 2,912,966 | (15,718,697) |
| Cash flows from investing activities: | | |
| Proceeds from sale of equity investment | 1,222,603 | — |
| Purchases of capital equipment | (2,944) | — |
| Other long-term assets | — | — |
| Net cash used in investing activities | 1,219,659 | — |
| Cash flows from financing activities: | | |
| Proceeds from issuance of convertible preferred stock, net | — | — |
| Proceeds from issuance of common stock, net | 5,000,000 | 16,300,730 |
| Dividends paid | (2,940,591) | — |
| Proceeds from short-term loans | 10,000,000 | — |
| Net cash provided by financing activities | 12,059,409 | 16,300,730 |
| Net increase in cash | 16,192,034 | 582,033 |
| Cash and cash equivalents at beginning of period | 15,362,447 | 8,678,329 |
| Cash and cash equivalents at end of period | <u>\$ 31,554,481</u> | <u>\$ 9,260,362</u> |

See notes to consolidated financial statements (unaudited).

HERCULES TECHNOLOGY GROWTH CAPITAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of Business and Unaudited Interim Consolidated Financial Statements Basis of Presentation

Hercules Technology Growth Capital, Inc. (the “Company”) is a specialty finance company that provides debt and equity growth capital to technology-related and life-science companies at all stages of development. The Company sources its investments through its principal office located in Silicon Valley, as well as through its additional offices in the Boston, Boulder and Chicago areas. The Company was incorporated under the General Corporation Law of the State of Maryland in December 2003. The Company commenced operations on February 2, 2004, when it sold 600 shares of convertible preferred stock to investors and commenced investment activities in September 2004.

The Company is an internally managed, non-diversified closed-end investment company that has elected to be regulated as a business development company (“BDC”) under the Investment Company Act of 1940, as amended (the “1940 Act”). In conjunction with the filing of its December 31, 2006 tax return, the Company intends to seek to be treated for federal income tax purposes as a registered investment company (“RIC”). As of March 31, 2006, the Company has not determined the probability that during 2006 it will qualify as a RIC when its 2006 tax return is filed. If the Company qualifies as a RIC as of December 31, 2006, the election will be effective as of January 1, 2006.

On June 11, 2005, the Company raised approximately \$70.9 million, net of issuance costs, from an initial public offering (“IPO”) of 6,000,000 shares of its common stock (see Note 11).

In January 2005, the Company 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 and additional contributions to regulatory capital. At March 31, 2006, the Company has a net investment of \$2.5 million in HT II and there is one outstanding loan in the amount of \$2.0 million, which was funded in 2005. HTM is a wholly-owned subsidiary of the Company. The Company is the sole limited partner of HT II and HTM is the general partner.

In July 2005, the Company formed Hercules Funding I LLC and Hercules Funding Trust I, an affiliated statutory trust, and executed a \$100 million securitized credit facility with Citigroup Global Markets Realty Corp. (see Note 4).

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The accompanying consolidated interim financial statements are presented in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information, and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual consolidated financial statements prepared in accordance with U.S. GAAP are omitted. In the opinion of management, all adjustments, consisting solely of normal recurring accruals considered necessary for the fair presentation of consolidated financial statements for the interim period, have been included. The current period’s results of operations are not necessarily indicative of results that ultimately may be achieved for the year. Therefore, the interim unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the period ended December 31, 2005, filed with the Securities and Exchange Commission on March 7, 2006. Financial statements prepared on a U.S. GAAP basis require management to

[Table of Contents](#)

make estimates and assumptions that affect the amounts and disclosures reported in the consolidated financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

2. Valuation of Investments

Value is defined in Section 2(a)(41) of the 1940 Act, as (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. Because, the Company invests primarily in structured mezzanine debt investments (“debt”) and equity growth capital (“equity”) of privately-held technology-related and life-science companies backed by leading venture capital and private equity firms, the Company values substantially all of its investments at fair value, as determined in good faith by the Board of Directors in accordance with established valuation policies and consistent procedures and the recommendations of the Valuation Committee of the Board of Directors. At March 31, 2006, approximately 90.8% of the Company’s investments are invested in privately held companies which are valued at fair value and approximately 9.2% are valued based on readily available market quotations.

Estimating fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment. Management estimates fair value to be the amount for which an investment could be exchanged in an orderly disposition over a reasonable period of time between willing parties other than in a forced or liquidation sale. Due to the inherent uncertainty in the valuation process, the Management’s estimate of fair value may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material. In addition, changes in the market environment and other events that may occur over the life of the investments may cause the gains or losses ultimately realized on these investments to be different than the valuations currently assigned.

When originating a debt instrument, the Company will receive warrants or other equity-related securities from the borrower. The Company determines the cost basis of the warrants or other equity-related securities received based upon their respective fair values on the date of receipt in proportion to the total fair value of the debt and warrants or other equity-related securities received. The Board of Directors estimates the fair value of warrants and other equity-related securities in good faith using a Black-Scholes pricing model and consideration of the issuer’s earnings, sales to third parties of similar securities, the comparison to publicly traded securities, and other factors. Any resulting discount on the loan from recordation of the warrant or other equity instruments is accreted into interest income over the life of the loan.

At each reporting date, privately held debt and equity securities are valued based on an analysis of various factors including, but not limited to, the portfolio company’s operating performance and financial condition and general market conditions that could impact the valuation. When an external event occurs, such as a purchase transaction, public offering, or subsequent equity sale, the pricing indicated by that external event is utilized to corroborate the Company’s valuation of the debt and equity securities. An unrealized loss is recorded when an investment has decreased in value, including: where collection of a loan is doubtful, there is an adverse change in the underlying collateral or operational performance, there is a change in the borrower’s ability to pay, or there are other factors that lead to a determination of a lower valuation for the debt or equity security. Conversely, an unrealized gain is recorded when the investment has appreciated in value. Securities that are traded in the over the counter markets or on a stock exchange will be valued at the prevailing bid price at period end.

As required by the 1940 Act, the Company classifies its investments by level of control. “Control Investments” are defined in the 1940 Act as investments in those companies that the Company is deemed to “Control”. “Affiliate Investments” are investments in those companies that are “Affiliated Companies” of the Company, as defined in the 1940 Act, which are not Control Investments. “Non-Control/Non-Affiliate Investments” are those that are neither Control Investments nor Affiliate Investments. Generally, under the 1940 Act, the Company is deemed to “Control” a company in which it has invested if it owns 25% or more of the

Table of Contents

voting securities of such company or has greater than 50% representation on its board. The Company is deemed to be an "Affiliate" of a company in which it has invested if it owns 5% or more but less than 25% of the voting securities of such company. At December 31, 2005 and 2004, all of the Company's investments were in Non-Control/Non-Affiliate companies.

Security transactions are recorded on the trade-date basis.

A summary of the composition of the Company's investment portfolio as of March 31, 2006 and December 31, 2005 at fair value is shown as follows:

| (\$ in millions) | March 31, 2006 | | December 31, 2005 | |
|---------------------------|---------------------------|-------------------------------|---------------------------|-------------------------------|
| | Investments at Fair Value | Percentage of Total Portfolio | Investments at Fair Value | Percentage of Total Portfolio |
| Senior debt with warrants | \$ 164.0 | 92.7% | \$ 163.4 | 92.4% |
| Subordinated debt | \$ 8.1 | 4.6% | 8.4 | 4.8% |
| Preferred stock | \$ 4.7 | 2.7% | 3.5 | 2% |
| Common stock | — | 0.0% | 1.4 | 0.8% |
| | <u>\$ 176.8</u> | <u>100.0%</u> | <u>\$ 176.7</u> | <u>100.0%</u> |

A Summary of the Company's investment portfolio, at value, by geographic location is as follows:

| (\$ in millions) | March 31, 2006 | | December 31, 2005 | |
|------------------|---------------------------|-------------------------------|---------------------------|-------------------------------|
| | Investments at Fair Value | Percentage of Total Portfolio | Investments at Fair Value | Percentage of Total Portfolio |
| United States | \$ 161.9 | 91.6% | \$ 159.9 | 90.5% |
| Canada | 14.9 | 8.4% | 16.8 | 9.5% |
| | <u>\$ 176.8</u> | <u>100.0%</u> | <u>\$ 176.7</u> | <u>100.0%</u> |

During the three-month period ended March 31, 2006, the Company purchased debt investments totaling \$32,500,000. In addition, during the three-month period ended March 31, 2006, the Company purchased equity securities of \$500,000.

Loan origination and commitment fees received in full at the inception of a loan are deferred and amortized into fee income as an enhancement to the related loan's yield over the contractual life of the loan. Loan exit fees to be paid at the termination of the loan are accreted into fee income over the contractual life of the loan. Original discount fees are reflected as adjustment to the loan yield. The Company had approximately \$3.0 million and \$2.7 of unamortized fees at March 31, 2006 and December 31, 2005, respectively, and approximately \$515,000 and \$351,000 million in exit fees receivable at March 31, 2006 and December 31, 2005, respectively.

3. Credit Facility

On April 12, 2005, the Company entered into a bridge loan credit facility (the "Bridge Loan Credit Facility" or the "Loan") with Alcmene Funding, L.L.C. ("Alcmene"), a special purpose vehicle that is an affiliate of Farallon Capital Management, L.L.C., a shareholder of the Company. The Loan was subsequently amended on August 1, 2005 and March 6, 2006. The Loan was originally a \$25 million senior secured term loan, allowing for up to an additional \$25 million of discretionary supplemental senior secured loans. The interest rate on borrowings under the Loan was set at 8% per annum for the initial six-month period. On August 1, 2005, the Company amended the Loan with an agreement extending the term of the Bridge Loan Credit Facility to April 12, 2006. The amendment 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

Table of Contents

collateral rights and financial covenants. On March 6, 2006, the Company entered into an agreement to repay \$10.0 million of the \$25.0 million outstanding under its Bridge Loan Credit Facility. The Company also 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.

The Loan is secured by a first lien on all of the Company's assets, except loans pledged under the Securitization Agreement (See Note 4) which are secured by a second lien. The Loan may be prepaid at any time by the Company without penalty. The Loan contains a mandatory pay-down provision requiring the Company to turn over to Alcmene all principal payments received by the Company from portfolio companies if at such time the Company has less than \$5 million in cash or cash equivalents on hand.

At March 31, 2006, there was \$15 million outstanding under the Loan, and the interest rate was 10.86% per annum. The average debt outstanding under the Credit Facility for the three months ended March 31, 2006 was approximately \$22.3 million and the average interest rate was approximately 12.8% (see Note 11).

4. Securitization Agreement

On August 1, 2005, the Company, through Hercules Funding Trust I, an affiliated statutory trust, executed a \$100 million securitized credit facility (the "Citigroup Facility") with Citigroup Global Markets Realty Corp. ("Citigroup"). The Company's 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 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 2007. The Citigroup Facility is collateralized by loans from the Company's portfolio companies, and includes an advance rate of approximately 55% of eligible loans. The Citigroup Facility contains covenants that, among other things, require the Company 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. In addition, the Citigroup Facility provides that Citigroup shall have a participation right equal to 10% of any realized gains, to a maximum of \$3.0 million, on equity instruments included in the loan collateral. At March 31, 2006, the Company has recorded an accrued liability of approximately \$366,000 related to unrealized gains on equity investments currently included in the collateral pool.

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%. The Company also paid a loan origination fee equal to 0.25% of the Citigroup Facility. On March 6, 2006, the Company amended the Citigroup facility with an agreement that increased the borrowing capacity under the facility to \$125.0 million, increased the advance rate to 60% of eligible loans and increased the eligible capacity for loans by geographic region. The amendment allows for an interest rate of LIBOR plus 2.5% on amounts borrowed in excess of \$100.0 million and an interest rate of LIBOR plus 5.0% for amounts borrowed in excess of 55% of eligible loans. The Company paid a restructuring fee of \$150,000 that will be expensed ratably through maturity on July 31, 2006.

At March 31, 2006, the Company, through its special purpose entity (SPE), had transferred pools of loans with a fair value of approximately \$136.4 million to Citibank and had drawn \$71.0 million under the facility. Transfers of loans have not met the requirements of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", for sales treatment and are, therefore, treated as secured borrowings, with the transferred loans remaining in investments and the related liability recorded in borrowings. The average debt outstanding under the Citigroup Facility for the three months ended March 31, 2006 was approximately \$60.4 million and the average interest rate was approximately 6.25%.

5. Shareholders' Equity

The Company is authorized to issue 30,000,000 shares of common stock with a par value of \$0.001. Each share of common stock entitles the holder to one vote.

Table of Contents

On February 2, 2004, the Company sold 600 shares of convertible preferred stock for gross proceeds of \$2,750,000 (\$2,575,000 net of the placement fee of \$175,000) to officers of the Company and JMP Group LLC ("JMPG"), an affiliate of the placement agent.

In June 2004, the Company sold in a private placement, 904,635 units for gross proceeds of \$26,614,080 (\$23,864,955 net of placement fees and offering costs of \$2,749,125), and all the convertible preferred stock was converted into 125,000 units on a 208.3333-for-1 basis. Each unit consisted of two shares of common stock, which were accompanied by a warrant to purchase one share of common stock within one year (the "1 Year Warrant"), and a warrant to purchase one share of common stock within five years (the "5 Year Warrant"). Each warrant had an exercise price of \$15.00 per share through January 13, 2005. As of December 31, 2004, there were no authorized shares of preferred stock.

In January 2005 the Company notified its shareholders of its intent to elect to be regulated as a BDC. In conjunction with the Company's decision to elect to be regulated as a BDC, approximately 55% of the 5 Year Warrants were subject to mandatory cancellation under the terms of the Warrant Agreement with the warrant holder receiving one share of common stock for every two warrants cancelled and the exercise price of all warrants was adjusted to the then current net asset value of the common stock, subject to certain adjustments described in the Warrant Agreement. In addition, the 1 Year Warrants became subject to expiration immediately prior to the Company's election to become a BDC, unless exercised. Concurrent with the announcement of the BDC election, the Company reduced the exercise price of all remaining 1 and 5 Year Warrants from \$15.00 to \$10.57. On February 22, 2005, the Company cancelled 47% of all outstanding 5 Year Warrants and issued 298,598 shares of common stock to holders of warrants upon exercise. In addition, the majority of shareholders owning 1 Year Warrants exercised them, and purchased 1,175,963 of common shares at \$10.57 per share, for total consideration to the Company of \$12,429,920. All unexercised 1 Year Warrants were then cancelled.

On January 26, 2005, the CEO, the President, and four employees purchased 40,000, 13,500, and 8,567 units for \$1,200,000, \$405,000 and \$257,010, respectively. On January 26, 2005, JMPG also purchased 72,000 units for \$2,008,800, which number is net of a placement fee of \$151,200, which was paid to an affiliate of JMPG.

On June 9, 2005, the Company raised approximately \$70.9 million, net of offering costs, from an IPO of 6,000,000 shares of its common stock. See Note 11.

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

On March 7, 2006, the Company issued 432,900 shares of common stock for approximately \$5.0 million in a private placement. The shares of common stock are subject to a registration rights agreement between the Company and the purchasers. Until the shares are registered pursuant to an effective registration statement, they will be restricted securities within the meaning of the Securities Act of 1933.

A summary of activity in the 5 Year Warrants initially attached to units issued for the three months ended March 31, 2006 is as follows:

| | Five-Year Warrants |
|---|-------------------------------|
| Warrants outstanding at December 31, 2005 | 616,672 |
| Warrants issued | — |
| Warrants cancelled | — |
| Warrants exercised | — |
| Warrants outstanding at March 31, 2006 | <u>616,672</u> |

Table of Contents

A summary of common stock options and warrant activity under the Company's equity incentive plan for the three months ended March 31, 2006, is as follows:

| | Common Stock Options | Five- Year Warrants |
|----------------------------------|----------------------------|---------------------------|
| Outstanding at December 31, 2005 | 1,337,436 | 56,551 |
| Granted | 3,500 | — |
| Exercised | — | — |
| Cancelled | — | — |
| Outstanding at March 31, 2006 | <u>1,340,936</u> | <u>56,551</u> |

6. Earnings per Share

Shares used in the computation of the Company's basic and diluted earnings (loss) per share are as follows:

| | Three months ended March 31, | |
|---|---------------------------------|------------------|
| | 2006 | 2005 |
| Weighted average common shares outstanding | 9,912,595 | 2,892,000 |
| Dilutive effect of warrants | 46,266 | — |
| Weighted average common shares outstanding, assuming dilution | <u>9,958,861</u> | <u>2,892,000</u> |

Weighted average common shares outstanding, assuming dilution, includes the incremental effect of shares that would be issued upon the assumed exercise of warrants. The Company has excluded all outstanding stock options from the calculation of diluted net loss per share because these securities are antidilutive for all periods presented. These excluded common share equivalents could be dilutive in the future. Options for approximately 1,341,000 and 273,000 shares of common stock have been excluded for the three months ended March 31, 2006 and 2005, respectively.

7. Related-Party Transactions

In January 2005, the Chief Executive Officer ("CEO"), the President, JMPG and four employees purchased 40,000, 13,500, 72,000 and 8,567 units for \$1,200,000, \$405,000, \$2,008,800 and \$257,010, respectively. On January 26, 2005, JMPG also purchased 72,000 units for \$2,008,800, which is net of an underwriting discount of \$151,200. Each unit consisted of two shares of our common stock, a 1 Year Warrant and a 5 Year Warrant.

On June 8, 2005, the Company entered into an Underwriting Agreement with JMP Securities LLC pursuant to which JMP Securities LLC served as the lead underwriter in the Company's initial public offering completed on June 9, 2006. The Company paid JMP Securities LLC a fee of approximately \$3.8 million in connection with their services as the lead underwriter.

8. Equity Incentive Plan

The Company has authorized and adopted an equity incentive plan (the "2004 Plan") for purposes of attracting and retaining the services of its executive officers and key employees. Under the 2004 Plan as amended and approved by the shareholders in 2005, the Company is authorized to issue 8,000,000 shares of common stock under the 2004 Plan. Unless terminated earlier by the Company's Board of Directors, the 2004 Plan will terminate on June 9, 2014, and no additional awards may be made under the 2004 Plan after that date.

In 2004, each employee stock option to purchase two shares of common stock was accompanied by a warrant to purchase one share of common stock within one year and a warrant to purchase one share of common

Table of Contents

stock within five years. Both options and warrants had an exercise price of \$15.00 per share on date of grant. On January 14, 2005, the Company notified all shareholders of its intent to elect to be regulated as a BDC and reduced the exercise price of all remaining 1 and 5 Year Warrants from \$15.00 to \$10.57 but did not reduce the strike price of the options (see Note 7). The unexercised one-year warrants expired and 55% of the five-year warrants were cancelled immediately prior to the Company's election to become a BDC.

9. Financial Highlights

Following is a schedule of financial highlights for the three months ended March 31, 2006 and 2005:

| | Three Months Ended March 31, | |
|---|------------------------------|-----------------------|
| | 2006 | 2005 |
| Per share data: | | |
| Net asset value at beginning of period | \$ 11.67 | \$ 12.18 |
| Net investment income | 0.03 | 0.01 |
| Net realized gain on investments | 0.15 | — |
| Net unrealized appreciation | 0.07 | — |
| Total from investment operations | 0.25 | 0.01 |
| Net decrease in net assets from capital share transactions | — | (1.30) |
| Dividends paid | (0.30) | — |
| Stock-based compensation expense included in investment loss ⁽¹⁾ | 0.01 | 0.01 |
| Net asset value at end of period | <u>\$ 11.63</u> | <u>\$ 10.90</u> |
| Ratios and supplemental data: | | |
| Per share market value at end of period | \$ 11.35 | N/A ⁽²⁾ |
| Total return | -2.84% ⁽³⁾ | 10.52% ⁽⁴⁾ |
| Shares outstanding at end of period | 10,234,865 | 3,801,965 |
| Weighted average number of common shares outstanding | 9,912,595 | 2,891,598 |
| Net assets at end of period | \$119,039,735 | \$41,435,233 |
| Ratio of operating expense to average net assets (annualized) | 15.39% ⁽⁵⁾ | 7.27% |
| Ratio of net investment income before provision for income tax expense and investment gains and losses (annualized) | 7.09% | 0.33% |
| Average debt outstanding | \$ 82,666,667 | \$ — |
| Weighted average debt per common share | \$ 8.34 | \$ — |

- (1) Stock option expense is a non-cash expense that has no effect on net asset value. Pursuant to Financial Accounting Standards No. 123 (revised 2004), net investment loss includes the expense associated with the granting of stock options which is offset by a corresponding increase in paid-in capital.
- (2) The Company completed the initial public offering of its common stock in June 2005, therefore, no market value data is presented as of March 31, 2005.
- (3) The total return for the period ended March 31, 2006 equals the change in the ending market value over the beginning of period price per share plus dividends paid per share during the period, divided by the beginning price.
- (4) The total return for the period ended March 31, 2005 is for a shareholder who owned common shares throughout the period, and received one additional common share for every two 5 Year Warrants cancelled. Shareholders who purchased common shares on January 26, 2005 or exercised 1 Year Warrants, will have a different total return. The Company completed its initial public offering on June 11, 2005, prior to that date shares were issued in a private placements.
- (5) The expense ratio excludes the income tax provision of \$1,760,000 for the quarter ended March 31, 2006. If the income tax provision were included the expense ratio would be 21.49%.

[Table of Contents](#)

10. Indemnification

The Company and its executives are covered by Directors and Officers Insurance, with the directors and officers being indemnified by the Company to the maximum extent permitted by Maryland law subject to the restrictions in the 1940 Act.

11. Subsequent Events

On April 21, 2006, the Company raised approximately \$34.0 million, net of estimated issuance costs, from a rights offering of 3,411,992 shares of its common stock. The shares were sold at \$10.55 per share which was equivalent to 95% of the volume weighted average price of shares traded during the ten days immediately prior to the closing.

On May 10, 2006, the Company repaid the \$15.0 million outstanding under the Bridge Loan Credit Facility plus a \$500,000 loan fee due on maturity and all accrued and unpaid interest through the date of repayment.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information set forth in both this Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the following Item 3 "Quantitative and Qualitative Disclosure about Market Risk" include "forward-looking statements" within the meaning of Section 21(e) of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended. Such forward-looking statements are subject to the safe harbor created by that section. Such statements may include, but are not limited to: projections of revenues, income or loss, capital expenditures, plans for product development and cooperative arrangements, future operations, financing needs, or plans of Hercules, as well as assumptions relating to the foregoing. The terms "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential," or "continue," or the negatives of these terms, or other similar expressions generally identify forward-looking statements.

The forward-looking statements made in these Items 2 and 3 speak only to events as of the date on which the statements are made. You should not place undue reliance on such forward-looking statements, as substantial risks and uncertainties could cause actual results to differ materially from those projected in or implied by these forward-looking statements due to a number of risks and uncertainties affecting its business. Factors that could cause our actual results to differ materially from those projected or implied in the forward-looking statements include, among others, those factors discussed under the caption "Risk Factors Relating to Hercules' Business." The forward-looking statements contained in this Form 10Q are made as of the date hereof, and Hercules assumes no obligation to update the forward-looking statements for subsequent events.

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 Internal Revenue Code (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

Table of Contents

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 have not determined the probability that during 2006 we will qualify as RIC when we file our 2006 federal tax return.

Portfolio and Investment Activity

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 \$176.8 million at March 31, 2006 as compared to \$176.7 million at December 31, 2005. During the three months ended March 31, 2006, we made debt commitments to 11 new portfolio companies totaling \$81.0 million and funded \$32.5 million to 10 companies including one existing portfolio company. During the quarter we also received normal principal repayments of approximately \$11.2 million and three companies made early repayments of \$22.8 million. We also made an equity investments in one existing portfolio company in 2005 totaling \$500,000 bringing total equity investments at fair value to approximately \$4.7 million at March 31, 2006. At March 31, 2006, we had unfunded contractual commitments of \$81.7 million to 15 portfolio companies.

Total portfolio investment activity (exclusive of unearned income) as of and for the period ended March 31, 2006 was as follows:

| (\$ in millions) | March 31, 2006 |
|---|-------------------|
| Beginning Portfolio | \$ 176.7 |
| Loan Originations | 32.5 |
| Equity Investments | 0.5 |
| Gross Payments/Reductions | (11.2) |
| Early Pay-offs | (22.8) |
| Accretion of loan discounts | 0.4 |
| Unrealized Appreciation in Investments, net | 0.7 |
| Ending Portfolio | <u>\$ 176.8</u> |

The following table shows the fair value of our portfolio of investments by asset class as of March 31, 2006 and December 31, 2005 (excluding unearned income):

| (\$ in millions) | March 31, 2006 | | December 31, 2005 | |
|---------------------------|------------------------------|----------------------------------|------------------------------|----------------------------------|
| | Investments at Fair Value | Percentage of Total Portfolio | Investments at Fair Value | Percentage of Total Portfolio |
| Senior debt with warrants | \$ 164.0 | 92.7% | \$ 163.4 | 92.4% |
| Subordinated debt | \$ 8.1 | 4.6% | 8.4 | 4.8% |
| Preferred stock | \$ 4.7 | 2.7% | 3.5 | 2% |
| Common stock | — | 0.0% | 1.4 | 0.8% |
| | <u>\$ 176.8</u> | <u>100.0%</u> | <u>\$ 176.7</u> | <u>100.0%</u> |

Table of Contents

The following table shows the fair value of our portfolio by industry sector at March 31, 2006 and December 31, 2005 (excluding unearned income):

| (\$ in millions) | March 31, 2006 | | December 31, 2005 | |
|---------------------------------------|---------------------------|-------------------------------|---------------------------|-------------------------------|
| | Investments at Fair Value | Percentage of Total Portfolio | Investments at Fair Value | Percentage of Total Portfolio |
| Biopharmaceuticals | \$ 53.7 | 30.4% | \$ 43.6 | 24.7% |
| Software | 32.8 | 18.6% | 29.0 | 16.4% |
| Consumer & business products | 20.7 | 11.7% | 19.8 | 11.2% |
| Communications & networking | 21.3 | 12.0% | 32.5 | 18.4% |
| Medical devices | 14.3 | 8.1% | 14.8 | 8.4% |
| Internet consumer & business services | 11.1 | 6.3% | 8.7 | 4.9% |
| Electronics & computer hardware | 10.9 | 6.2% | 17.8 | 10.1% |
| Semiconductors | 10.5 | 5.9% | 10.5 | 5.9% |
| Energy | 1.5 | 0.8% | — | 0.0% |
| | <u>\$ 176.8</u> | <u>100.0%</u> | <u>\$ 176.7</u> | <u>100.0%</u> |

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 the debt investments in our portfolio with 1 being the highest quality. 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 March 31, 2006 and December 31, 2005:

| (\$ in millions) | March 31, 2006 | | December 31, 2005 | |
|---------------------------|---------------------------|-------------------------------|---------------------------|-------------------------------|
| | Investments at Fair Value | Percentage of Total Portfolio | Investments at Fair Value | Percentage of Total Portfolio |
| Investment Grading | | | | |
| 1 | \$ 13.7 | 8.0% | \$ 9.9 | 5.8% |
| 2 | 142.9 | 83.0 | 150.3 | 87.5 |
| 3 | 12.5 | 7.3 | 5.8 | 3.4 |
| 4 | 3.0 | 1.7 | 4.5 | 2.6 |
| 5 | — | — | 1.3 ⁽¹⁾ | 0.7 |
| | <u>\$ 172.1</u> | <u>100%</u> | <u>\$ 171.8</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 \$469,000 in the first quarter of 2006. We may receive future distributions related to this sale but such distributions are contingent on future deliverables.

As of March 31, 2006, our investments had a weighted average investment grading of 2.04.

At March 31, 2006, the weighted average yield to maturity of our loan obligations was approximately 12.60%. Yields to maturity are computed using interest rates as of March 31, 2006 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

Table of Contents

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

Comparison of the Three Months Ended March 31, 2006 and 2005

Operating Income

Interest income totaled approximately \$5.6 million for the three-month period ended March 31, 2006, an increase of \$4.9 million or 734% as compared to \$676,000 in the first quarter of 2005. Income from commitment and facility fees totaled approximately \$852,000 and \$78,000 for the three-month period ended March 31, 2006 and 2005, respectively. The increases are the result of origination activity and yield from the related investments. At March 31, 2006, we had approximately \$3.0 million of deferred revenue related to commitment and facility fees, as compared to approximately \$637,000 as of March 31, 2005. We expect to generate additional interest income and loan fees as we continue to originate additional investments.

Operating Expenses

Operating expenses totaled approximately \$4.4 million and \$722,000 during the three-month periods ended March 31, 2006 and 2005, respectively. Operating expenses for the first quarter of 2006 included interest expense, loan fees and unused commitment fees under our Bridge Loan Credit Facility and the Citigroup Facility of approximately \$1.9 million. There were no interest, loan, or commitment fees during the three-month period ended March 31, 2005. Employee compensation and benefits were approximately \$1.2 million and \$495,000 during the three-month periods ended March 31, 2006 and 2005, respectively. The increase in compensation expense was directly related to increasing our headcount from 11 employees at March 31, 2005 to 19 employees at March 31, 2006. General and administrative expenses increased to \$1.2 million from \$203,000 during the first quarter of 2005 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 \$123,000 of stock-based compensation expense in the first quarter of 2006 as compared to \$24,000 in 2005. 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 provision for income tax expense for the three-months ended March 31, 2006 totaled \$2.0 million as compared with net investment income before provision for income tax expense in the first quarter of 2005 of approximately \$32,000. This change is made up of the items described above.

Table of Contents

Net Investment Gains

We generated a net realized gain totaling approximately \$1.1 million from the sale of common stock of one biopharmaceutical portfolio company and we recognized a gain of approximately \$469,000 from additional recoveries on one portfolio company that was sold during the first quarter of 2006.

For the three-months ended March 31, 2006, net unrealized investment appreciation totaled approximately \$674,000. 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. At March 31, 2006, cumulative gross unrealized appreciation totaled approximately \$5.7 million in 11 of our portfolio investment companies and approximately \$1.1 million of gross unrealized depreciation on 26 of our portfolio investment companies. The net unrealized appreciation totaling approximately \$674,000 was the result of a net increase in the warrant portfolio of \$2.1 million offset by net unrealized losses in the equity portfolio of \$376,000, the write down of one portfolio by approximately \$908,000 and a further reduction of approximately \$159,000 related to the Citigroup warrant participation agreement. The reduction in the equity portfolio was primarily due to the turn around affect of selling shares of appreciated stock in one portfolio company in the warrant portfolio offset by an appreciation in one equity holding. We did not recognize any realized or unrealized gains or losses during the period ended March 31, 2005.

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

For the three-months ended March 31, 2006, net income totaled approximately \$2.5 million compared to net income of approximately \$32,000 for the three-months ended March 31, 2005. These changes are made up of the items previously described.

Basic and diluted net income per share for the three-months ended March 31, 2006 was \$0.25 as compared to a basic and diluted income per share of \$0.01 for the three-months ended March 31, 2005.

Financial Condition, Liquidity, and Capital Resources

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 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 the three-months ended March 31, 2006, net cash used in operating activities totaled approximately \$2.9 million. This use of cash was due primarily due to \$33.0 million used for investments in our portfolio companies offset by proceeds of \$33.9 million in principal repayments, a \$1.1 million realized gain on the stock of one portfolio company and an increase in accrued liabilities of \$1.0 million. Cash provided by investing activities for the three-months ended March 31, 2006 totaled \$1.2 million and was primarily due to proceeds from the sale of

Table of Contents

common stock in one portfolio company. Net cash provided by financing activities totaled \$12.1 million for the first three months of 2006. In March, we received \$5.0 million in proceeds from the sale of common stock and \$10.0 million from borrowings under our credit facilities, offset by a dividend payment of \$2.9 million.

As of March 31, 2006, net assets totaled \$119 million, with a net asset value per share of \$11.63, and we had approximately \$31.6 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 March 31, 2006 was approximately 238%.

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 March 31, 2006, based on eligible loans in the investment portfolio and existing advance rates, we had approximately \$1.9 million of borrowing capacity available under our existing \$125 million securitized credit facility from Citigroup and \$136.4 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 \$1.9 million. Advances under the facility bear interest at one-month LIBOR plus 165 basis points. We anticipate that portfolio fundings entered into in succeeding periods will allow us to utilize the full borrowing capacity of the Citigroup Facility.

On April 21, 2006, we raised approximately \$34.0 million, net of estimated issuance costs, from a rights offering of 3,411,992 shares of our common stock. The shares were sold at \$10.55 per share which was equivalent to 95% of the volume weighted average price of shares traded during the ten days immediately prior to the closing. We believe these funding sources combined with cash on hand at March 31, 2006, cash provided from operations and financing activities will allow us to continue investing activities for 6 to 12 months. In order to fund new originations beyond this expected period, 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 March 31, 2006, we had unfunded commitments of approximately \$81.7 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.

Table of Contents

Contractual Obligations

The following table shows our contractual obligations as of March 31, 2006:

| Contractual Obligations ⁽¹⁾ | Payments due by period (dollars in thousands) | | | | |
|--|--|---------------------|---------------|---------------|------------------|
| | Total | Less than 1 year | 1- 3 years | 3- 5 years | After 5 years |
| Borrowings ⁽²⁾ | \$86,000 | \$86,000 | — | — | — |
| Operating lease obligations | 244 | 244 | — | — | — |
| Total | <u>\$86,244</u> | <u>\$86,244</u> | <u>—</u> | <u>—</u> | <u>—</u> |

(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.

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%. On May 10, 2006, we repaid \$15.0 million of the Bridge Loan Credit Facility plus a \$500,000 loan fee due on maturity and all accrued and unpaid interest through the date of repayment.

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 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 \$71.0 million of outstanding borrowings under the Citigroup Facility at March 31, 2006.

Table of Contents

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."

Dividends

On April 3, 2006, we declared a dividend of \$0.30 per common share for holders of record on April 10, 2006. This dividend totaled approximately \$3.1 million and was distributed on May 5, 2006.

The following table summarizes our dividends declared and paid on all shares, including restricted stock, to date:

| <u>Date Declared</u> | <u>Record Date</u> | <u>Payment Date</u> | <u>Amount</u> |
|----------------------|--------------------|---------------------|-----------------|
| October 27, 2005 | November 1, 2005 | November 17, 2005 | \$ 0.025 |
| December 9, 2005 | January 6, 2006 | January 27, 2006 | \$ 0.300 |
| April 3, 2006 | April 10, 2006 | May 5, 2006 | \$ 0.300 |
| | | | <u>\$ 0.625</u> |

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 have not determined the probability that during 2006 we will qualify as RIC when we file our 2006 federal tax return.

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 have reasonably ascertained that we will meet the required qualifications for a RIC.

Table of Contents

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 \$181,000 deferred tax asset on our balance sheet at March 31, 2006. If we had been able to make the determination as March 31, 2006, the impact of reversing the deferred tax assets and deferred tax liabilities to operations would have increased our NAV by approximately \$0.03 per share. In addition, our taxable income per share as a RIC would have been approximately \$0.30 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. 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. 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 consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and revenues and expenses during the period reported. On an ongoing basis, our management evaluates its estimates and assumptions, which

Table of Contents

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 consolidated financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded.

As a BDC, we invest primarily in illiquid securities, including debt and equity-related securities of private companies. Our investments are generally subject to some 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 March 31, 2006, approximately 85% 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 Management and approved by the Valuation Committee of 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 Management 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 Management 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. Loan facility fees, original issue discount, commitment fees, and market premium or discount are deferred and amortized into interest income as adjustments to the related loan's yield over the contractual life of the loan. The Company stops accruing interest on its investments when it is determined that interest is no longer collectible.

Fee Income. Fee income includes 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 when the services are rendered.

Stock-Based Compensation. We have issued and may, from time to time, issue additional stock options to employees and consultants under our 2004 Equity Incentive Plan. We follow Financial Accounting Standards

Table of Contents

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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to financial market risks, including changes in interest rates. As of March 31, 2006, 32 of our loan agreements were at fixed rates and nine loans were at variable rates. Over time some of our investments will be at variable rates. We may, in the future, hedge against interest rate fluctuations by using standard hedging instruments such as futures, options, and forward contracts. While hedging activities may insulate us against changes in interest rates, they may also limit our ability to participate in the benefits of lower interest rates with respect to our borrowed funds and higher interest rates with respect to our portfolio of investments.

Obligations and Indebtedness

On April 12, 2005, we entered into a Bridge Loan Credit Facility to provide us with additional capital to invest prior to the completion of our IPO. In addition, on August 1, 2005, we entered into the Citigroup Facility, a securitized credit facility. We expect to pursue additional debt financing from the SBA under its SBIC 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 lender or lenders under such a facility 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.

Bridge Financing

On April 12, 2005, we entered into a Bridge Loan Credit Facility with Alceme 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 \$10.0 million of the Bridge Loan Credit Facility. The Bridge Loan Credit Facility consists of a \$25 million senior secured first lien term loan, plus up to an additional \$25 million of discretionary supplemental senior secured first lien term loans. The supplemental loans, if any, will be made on terms to be agreed upon between us and Alceme. 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

Table of Contents

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. As of December 31, 2005 we had approximately \$25.0 million outstanding under the Bridge Loan Credit Facility. In addition, at December 31, 2005, we had approximately \$198,000 of prepaid fees related to the upfront draw down fee and accrued \$302,000 for fees related to the maturity fee.

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%. On May 10, 2006, we repaid \$15.0 million of the Bridge Loan Credit Facility plus a \$500,000 loan fee due on maturity and all accrued and unpaid interest through the date of repayment.

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 March 31, 2006 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 \$71.0 million of borrowings outstanding under the Citigroup Facility at March 31, 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

Table of Contents

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.

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.

ITEM 4. CONTROLS AND PROCEDURES

Our chief executive and chief legal officers, under the supervision and with the participation of our management, conducted an evaluation of our disclosure controls and procedures, as defined in Rules 13a-15 and 15d-15 of the Exchange Act. As of the end of the period covered by this quarterly report on Form 10-Q, our chief executive and chief legal officers have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and that information required to be disclosed by us in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its chief executive and chief legal officers, as appropriate to allow timely decisions regarding required disclosure.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis, to improve the controls and procedures over time, and to correct any deficiencies that we may discover in the future. Our goal is to ensure that senior management has timely access to all material financial and non-financial information concerning our business. While we believe that the present design of our disclosure controls and procedures is effective to achieve this goal, future events affecting our business may cause us to modify disclosure controls and procedures.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Hercules is not currently party to any legal proceedings.

ITEM 1A.

For information regarding risk factors, please refer to Item 1A in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

| Exhibit Number | Description |
|---------------------------|---|
| 31.1 | Chief Executive Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Principal Financial and Accounting Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Chief Executive Officer Certification pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Principal Financial and Accounting Officer Certification pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

EXHIBIT INDEX

| Exhibit Number | Description |
|-----------------------|---|
| 31.1 | Chief Executive Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Principal Financial and Accounting Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Chief Executive Officer Certification pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Principal Financial and Accounting Officer Certification pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

**CERTIFICATION PURSUANT TO
RULE 13a-14(a) and 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS AMENDED**

I, Manuel A. Henriquez, President, Chief Executive Officer and Director of the Company, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Hercules Technology Growth Capital, Inc. (the "registrant") for the quarter ended March 31, 2006;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 12, 2006

By: _____ /s/ MANUEL A. HENRIQUEZ
Manuel A. Henriquez
Chief Executive Officer

**CERTIFICATION PURSUANT TO
RULE 13a-14(a) and 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS AMENDED**

I, David M. Lund, Vice President of Finance and Senior Corporate Controller (Principal Financial and Accounting Officer), certify that:

1. I have reviewed this report on Form 10-Q of Hercules Technology Growth Capital, Inc. (the "registrant") for the quarter ended March 31, 2006;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 12, 2006

By: _____ /s/ DAVID M. LUND
David M. Lund
Vice President of Finance and
Senior Corporate Controller
(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO
SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned, as chief executive officer of Hercules Technology Growth Capital, Inc. (the "Company"), does hereby certify that to the undersigned's knowledge:

- 1) the Company's Form 10-Q for the three months ended March 31, 2006 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- 2) the information contained in the Company's Form 10-Q for the three months ended March 31, 2006 fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 12, 2006

By: _____ /s/ MANUEL A. HENRIQUEZ
Manuel A. Henriquez
Chief Executive Officer

**CERTIFICATION PURSUANT TO
SECTION 1350, CHAPTER 63 OF TITLE 18, UNITED STATES CODE,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned, as principal financial and accounting officer of Hercules Technology Growth Capital, Inc. (the "Company"), does hereby certify that to the undersigned's knowledge:

- 1) the Company's Form 10-Q for the three months ended March 31, 2006 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- 2) the information contained in the Company's Form 10-Q for the three months ended March 31, 2006 fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 12, 2006

By: _____ /s/ DAVID M. LUND
David M. Lund
Vice President of Finance and
Senior Corporate Controller
(Principal Financial and Accounting Officer)