

HARRIS & HARRIS GROUP INC /NY/
Form 10-Q
November 08, 2010

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

Form 10-Q

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

For the quarterly period ended September 30, 2010

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

For the transition period from _____ to _____

Commission file number: 0-11576

HARRIS & HARRIS GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

New York
(State or Other Jurisdiction of
Incorporation or Organization)

13-3119827
(I.R.S. Employer Identification No.)

1450 Broadway, New York, New York
(Address of Principal Executive Offices)

10018
(Zip Code)

(212) 582-0900
(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 period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer

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Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at November 8, 2010
Common Stock, \$0.01 par value per share	30,872,858 shares

Harris & Harris Group, Inc.
Form 10-Q, September 30, 2010

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

The information furnished in the accompanying consolidated financial statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim period presented.

Harris & Harris Group, Inc.® (the "Company," "us," "our" and "we"), is an internally managed venture capital company that has elected to operate as a business development company ("BDC") under the Investment Company Act of 1940 (the "1940 Act"). Certain information and disclosures normally included in the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted as permitted by Regulation S-X and Regulation S-K. Accordingly, they do not include all information and disclosures necessary for a presentation of our financial position, results of operations and cash flows in conformity with GAAP. The results of operations for any interim period are not necessarily indicative of the results for the full year. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2009.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

ASSETS

	September 30, 2010 (Unaudited)	December 31, 2009
Investments, in portfolio securities at value:		
Unaffiliated privately held companies (cost: \$37,470,081 and \$26,977,200, respectively)	\$ 47,369,210	\$ 21,656,436
Unaffiliated publicly traded securities (cost: \$0 and \$298,827, respectively)	0	226,395
Non-controlled affiliated privately held companies (cost: \$51,536,674 and \$54,864,948, respectively)	40,978,655	50,297,220
Controlled affiliated privately held companies (cost: \$9,380,567 and \$10,248,932, respectively)	8,431,564	5,843,430
Total, investments in privately held and publicly traded securities at value (cost: \$98,387,322 and \$92,389,907, respectively)	\$ 96,779,429	\$ 78,023,481
Investments, in U.S. Treasury obligations at value (cost: \$43,861,592 and \$55,960,024, respectively)	43,860,344	55,947,581
Cash	256,103	1,611,465
Restricted funds	2,001	2,000
Receivable from portfolio company	10,000	28,247
Interest receivable	2,104	25,832
Prepaid expenses	97,996	94,129
Other assets	622,244	376,366
Total assets	\$ 141,630,221	\$ 136,109,101

LIABILITIES & NET ASSETS

Post retirement plan liabilities	\$ 1,471,159	\$ 1,369,843
Accounts payable and accrued liabilities	532,717	579,162
Deferred rent	345,835	1,838
Total liabilities	2,349,711	1,950,843
Net assets	\$ 139,280,510	\$ 134,158,258
Net assets are comprised of:		
Preferred stock, \$0.10 par value, 2,000,000 shares authorized; none issued	\$ 0	\$ 0

Common stock, \$0.01 par value, 45,000,000 shares
authorized at

09/30/10 and 12/31/09; 32,698,945 issued at

09/30/10

and 32,688,333 issued at 12/31/09

	326,990	326,884
Additional paid in capital (Note 8)	207,714,612	205,977,117
Accumulated net operating and realized loss	(63,746,420)	(54,361,343)
Accumulated unrealized depreciation of investments	(1,609,141)	(14,378,869)
Treasury stock, at cost (1,828,740 shares at 09/30/10 and 12/31/09)	(3,405,531)	(3,405,531)
Net assets	\$ 139,280,510	\$ 134,158,258
Shares outstanding	30,870,205	30,859,593
Net asset value per outstanding share	\$ 4.51	\$ 4.35

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2010	2009	2010	2009
Investment income:				
Interest from:				
Fixed-income securities and bridge notes (Note 3)	\$ 134,097	\$ 99,677	\$ 330,378	\$ 138,862
Miscellaneous income	6,348	6,000	18,348	27,088
Total investment income	140,445	105,677	348,726	165,950
Expenses:				
Salaries, benefits and stock-based compensation (Note 6)	1,327,055	1,727,743	4,181,852	4,621,680
Administration and operations	201,222	225,044	711,990	746,640
Professional fees	136,643	190,942	556,878	558,483
Rent (Note 3)	136,879	79,617	303,239	236,678
Directors' fees and expenses	70,359	79,136	251,280	252,745
Custody fees	24,000	33,515	72,000	51,457
Depreciation	13,151	12,633	38,940	38,370
Lease termination costs (Note 3)	0	0	68,038	0
Total expenses	1,909,309	2,348,630	6,184,217	6,506,053
Net operating loss	(1,768,864)	(2,242,953)	(5,835,491)	(6,340,103)
Net realized gain (loss):				
Realized gain (loss) from investments:				
Unaffiliated companies	0	0	13,218	(1,514,330)
Non-Controlled affiliated companies	(3,136,552)	(3,176,125)	(3,393,559)	(3,176,125)
Publicly traded companies	0	0	(152,980)	0
U.S. Treasury obligations/other	(311)	0	(11,834)	(325)
Realized loss from investments	(3,136,863)	(3,176,125)	(3,545,155)	(4,690,780)
Income tax expense (benefit) (Note 7)	1,799	(2,862)	4,431	(753)
Net realized loss	(3,138,662)	(3,173,263)	(3,549,586)	(4,690,027)
Net decrease in unrealized depreciation on investments:				
Change as a result of investment sales	3,136,552	3,180,240	3,358,871	4,691,282
Change on investments held	1,316,942	1,939,657	9,410,857	5,512,472
Net decrease in unrealized depreciation on investments	4,453,494	5,119,897	12,769,728	10,203,754
Net (decrease) increase in net assets resulting from operations	\$ (454,032)	\$ (296,319)	\$ 3,384,651	\$ (826,376)

Per average basic outstanding share	\$	(0.01)	\$	(0.01)	\$	0.11	\$	(0.03)
Average outstanding shares		30,866,399		25,866,983		30,863,616		25,862,070

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows used in operating activities:		
Net increase (decrease) in net assets resulting from operations	\$ 3,384,651	\$ (826,376)
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash used in operating activities:		
Net realized and unrealized gain on investments	(9,224,573)	(5,512,974)
Depreciation of fixed assets, amortization of premiums or discounts and bridge note interest	(260,793)	39,784
Stock-based compensation expense	1,746,734	2,425,525
Changes in assets and liabilities:		
Restricted funds	(1)	189,970
Receivable from portfolio company	18,247	0
Other receivables	7,187	(217)
Return of security deposits on leased properties	44,376	0
Interest receivable	11,513	2,044
Income tax receivable	0	(3,353)
Prepaid expenses	(3,867)	335,914
Other assets	(227,512)	(186,116)
Post retirement plan liabilities	101,316	(60,403)
Accounts payable and accrued liabilities	(46,445)	(147,329)
Deferred rent	343,997	(4,727)
Net cash used in operating activities	(4,105,170)	(3,748,258)
Cash flows from investing activities:		
Purchase of U.S. government securities	(58,644,919)	(112,308,457)
Sale of U.S. government securities	70,746,244	123,988,254
Investments in affiliated portfolio companies	(7,489,948)	(6,561,959)
Investments in unaffiliated portfolio companies	(2,177,123)	(973,915)
Proceeds from conversion of bridge note	1,356	0
Proceeds from sale of investments	407,543	7,365
Purchase of fixed assets	(84,212)	(1,313)
Net cash provided by investing activities	2,758,941	4,149,975
Cash flows from financing activities:		
Proceeds from stock option exercises	39,795	401,944
Payment of offering costs	(48,928)	0
Net cash (used in) provided by financing activities	(9,133)	401,944

Net decrease in cash:			
Cash at beginning of the period		1,611,465	692,309
Cash at end of the period.		256,103	1,495,970
Net (decrease) increase in cash	\$	(1,355,362)	\$ 803,661
Supplemental disclosures of cash flow information:			
Income taxes paid	\$	4,431	\$ 2,179

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

	Nine Months Ended September 30, 2010 (Unaudited)	Year Ended December 31, 2009
Changes in net assets from operations:		
Net operating loss	\$ (5,835,491)	\$ (8,761,215)
Net realized loss on investments	(3,549,586)	(11,105,577)
Net decrease in unrealized depreciation on investments as a result of sales	3,358,871	11,090,579
Net decrease in unrealized depreciation on investments held	9,410,857	8,627,748
Net increase (decrease) in net assets resulting from operations	3,384,651	(148,465)
Changes in net assets from capital stock transactions:		
Issuance of common stock upon the exercise of stock options	106	1,125
Issuance of common stock on offering	0	48,875
Additional paid-in capital on common stock issued and options exercised	(9,239)	21,636,090
Stock-based compensation expense	1,746,734	3,089,520
Net increase in net assets resulting from capital stock transactions	1,737,601	24,775,610
Net increase in net assets	5,122,252	24,627,145
Net assets:		
Beginning of the period	134,158,258	109,531,113
End of the period	\$ 139,280,510	\$ 134,158,258

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

	Method of Valuation (1)	Industry (2)	Shares/ Principal	Value
Investments in Unaffiliated Companies (3)(4) – 34.0% of net assets at value				
Private Placement Portfolio (Illiquid) – 34.0% of net assets at value				
BioVex Group, Inc. (5)(6)(7)(8) -- Developing novel biologics for treatment of cancer and infectious disease		Healthcare/ Biotech		
Series E Convertible Preferred Stock	(M)		2,799,552	\$ 1,303,583
Series G Convertible Preferred Stock	(M)		6,964,034	1,462,448
Warrants for Series G Convertible Preferred Stock expiring 11/5/16	(I)		285,427	21,407
				2,787,438
Bridgelux, Inc. (5)(6) -- Manufacturing high-power light emitting diodes (LEDs) and arrays		Cleantech		
Series B Convertible Preferred Stock	(M)		1,861,504	1,759,121
Series C Convertible Preferred Stock	(M)		2,130,699	2,013,511
Series D Convertible Preferred Stock	(M)		999,999	944,998
Warrants for Series C Convertible Preferred Stock expiring 12/31/14	(I)		163,900	91,128
Warrants for Series D Convertible Preferred Stock expiring 8/26/14	(I)		166,665	64,833
				4,873,591
Cobalt Technologies, Inc. (5)(6)(7)(9) -- Developing processes for making biobutanol through biomass fermentation		Cleantech		
Series C Convertible Preferred Stock	(M)		352,112	375,000
Healthcare/				

Ensemble Therapeutics Corporation (5)(6)(10) -- Developing DNA- Programmed Chemistry™ for the discovery of new classes of therapeutics		Biotech		
Series B Convertible Preferred Stock	(M)		1,449,275	2,000,000
Unsecured Convertible Bridge Notes (including interest)	(M)		\$ 299,169	343,473
				2,343,473

GEO Semiconductor Inc. (7)(13) -- Developing programmable, high-performance video and geometry processing solutions		Electronics/ Semi- conductors		
Participation Agreement with Montage Capital relating to the following assets:				
Senior Secured Debt, 13.75%, maturing on 06/30/12	(I)		\$ 500,000	443,600
Warrants for Series A Preferred Stock expiring on 09/17/17	(I)		100,000	46,800
				490,400

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

	Method of Valuation (1)	Industry (2)	Shares/ Principal	Value
Investments in Unaffiliated Companies (3)(4) – 34.0% of net assets at value (Cont.)				
Private Placement Portfolio (Illiquid) – 34.0% of net assets at value (Cont.)				
Electronics/				
Molecular Imprints, Inc. (5)(6) -- Manufacturing nanoimprint lithography capital equipment		Semi- conductors		
Series B Convertible Preferred Stock	(M)		1,333,333	\$ 2,000,000
Series C Convertible Preferred Stock	(M)		1,250,000	1,875,000
Warrants for Series C Convertible Preferred Stock expiring 12/31/11	(I)		125,000	69,875
				3,944,875
Cleantech				
Nanosys, Inc. (5)(6) -- Developing inorganic nanowires and quantum dots for use in batteries and LED-backlit devices				
Series C Convertible Preferred Stock	(M)		803,428	1,021,835
Series D Convertible Preferred Stock	(M)		1,016,950	1,382,573
Series E Convertible Preferred Stock	(M)		433,688	496,573
				2,900,981
Electronics/				
Nantero, Inc. (5)(6)(7) -- Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes		Semi- conductors		
Series A Convertible Preferred Stock	(M)		345,070	1,046,908
Series B Convertible Preferred Stock	(M)		207,051	628,172
Series C Convertible Preferred Stock	(M)		188,315	571,329
				2,246,409
Other				
NeoPhotonics Corporation (5)(6) -- Developing and manufacturing				

optical devices and components			
Common Stock	(M)	1,130,440	931,483
Series 1 Convertible Preferred Stock	(M)	1,831,256	1,508,955
Series 2 Convertible Preferred Stock	(M)	741,898	611,324
Series 3 Convertible Preferred Stock	(M)	2,750,000	2,266,000
Series X Convertible Preferred Stock	(M)	8,923	1,427,680
			6,745,442

Polatis, Inc. (5)(6)(7) -- Developing MEMS-based

optical		Other	
networking components			
Common Stock	(M)	16,438	0
Series A-1 Convertible Preferred Stock	(M)	16,775	0
Series A-2 Convertible Preferred Stock	(M)	71,611	0
Series A-4 Convertible Preferred Stock	(M)	4,774	0
			0

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HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

	Method of Valuation (1)	Industry (2)	Shares/ Principal	Value
Investments in Unaffiliated Companies (3)(4) – 34.0% of net assets at value (Cont.)				
Private Placement Portfolio (Illiquid) – 34.0% of net assets at value (Cont.)				
PolyRemedy, Inc. (5)(6)(7) -- Developing a platform for producing and tracking the use of wound treatment patches				
		Healthcare/ Biotech		
Series B-1 Convertible Preferred Stock	(M)		287,647	\$ 23,466
Series B-2 Convertible Preferred Stock	(M)		676,147	30,427
				53,893
Siluria Technologies, Inc. (5)(6)(7) -- Developing nanomaterials for manufacturing of chemicals				
		Cleantech		
Series S-2 Convertible Preferred Stock	(M)		612,061	204,000
Solazyme, Inc. (5)(6)(7) -- Developing algal biodiesel, industrial chemicals and specialty ingredients using synthetic biology				
		Cleantech		
Series A Convertible Preferred Stock	(M)		988,204	8,750,744
Series B Convertible Preferred Stock	(M)		495,246	4,385,502
Series C Convertible Preferred Stock	(M)		651,309	5,767,471
Series D Convertible Preferred Stock	(M)		169,390	1,499,991
				20,403,708
TetraVitae Bioscience, Inc. (5)(6)(7)(11) -- Developing methods of producing alternative chemicals and fuels through biomass fermentation				
		Cleantech		
Series B Convertible Preferred Stock	(M)		118,804	0

Total Unaffiliated Private Placement Portfolio (cost: \$37,470,081)	\$ 47,369,210
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Total Investments in Unaffiliated Companies (cost: \$37,470,081)	\$ 47,369,210
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The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

	Method of Valuation (1)	Industry (2)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3)(12) – 29.4% of net assets at value				
Private Placement Portfolio (Illiquid) – 29.4% of net assets at value				
ABS Materials, Inc. (5)(7)(13) -- Developing nano-structured absorbent materials for environmental remediation and for the petroleum industry		Cleantech		
Series A Convertible Preferred Stock	(M)		375,000	\$ 375,000
Adesto Technologies Corporation (5)(6)(7) -- Developing low-power, high-performance memory devices		Electronics/ Semi- conductors		
Series A Convertible Preferred Stock	(M)		6,547,619	2,420,000
Series B Convertible Preferred Stock	(M)		5,952,381	2,200,000
				4,620,000
Cambrios Technologies Corporation (5)(6)(7) – Developing nanowire-enabled electronic materials for the display industry		Electronics/ Semi- conductors		
Series B Convertible Preferred Stock	(M)		1,294,025	647,013
Series C Convertible Preferred Stock	(M)		1,300,000	650,000
Series D Convertible Preferred Stock	(M)		515,756	257,878
				1,554,891
Contour Energy Systems, Inc. (5)(6)(7)(14) -- Developing batteries using nanostructured materials		Cleantech		
Series A Convertible Preferred Stock	(M)		2,565,798	2,822,378
Series B Convertible Preferred Stock	(M)		812,500	1,300,000
				4,122,378
Crystal IS, Inc. (5)(6) -- Developing single-crystal aluminum nitride substrates for light-emitting diodes		Cleantech		
Common Stock	(M)		3,994,468	0
Warrants for Series A-1 Preferred Stock expiring 05/05/13	(I)		15,231	0
Warrants for Series A-1 Preferred Stock expiring 05/12/13	(I)		2,350	0
Warrants for Series A-1 Preferred Stock expiring 08/08/13	(I)		4,396	0
				0

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HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

	Method of Valuation (1)	Industry (2)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies				
(3)(12) –				
29.4% of net assets at value (Cont.)				
Private Placement Portfolio (Illiquid) – 29.4% of net assets at value (Cont.)				
D-Wave Systems, Inc. (5)(6)(7)(15) -- Developing high-performance quantum computing systems				
		Electronics/ Semi-conductors		
Series B Convertible Preferred Stock	(M)		1,144,869	\$ 1,232,451
Series C Convertible Preferred Stock	(M)		450,450	484,909
Series D Convertible Preferred Stock	(M)		1,533,395	1,650,700
Unsecured Convertible Bridge Note (including interest)	(M)		\$ 580,257	612,070
Warrants for Common Stock expiring 06/30/15	(I)		153,890	73,713
				4,053,843
Enumeral Technologies, Inc. (5)(6)(7) -- Developing therapeutics and diagnostics through functional assaying of single cells				
		Healthcare/ Biotech		
Unsecured Convertible Bridge Note (including interest)	(M)		\$ 250,000	265,452
Innovalight, Inc. (5)(6)(7) -- Developing silicon-based nanomaterials for use in the solar energy industry				
		Cleantech		
Series B Convertible Preferred Stock	(M)		16,666,666	2,227,333
Series C Convertible Preferred Stock	(M)		5,810,577	957,378
Series D Convertible Preferred Stock	(M)		4,046,974	540,838
				3,725,549
Kovio, Inc. (5)(6) -- Developing semiconductor products using printed electronics and thin-film technologies				
		Electronics/ Semi-conductors		
Series A' Convertible Preferred Stock	(M)		2,686,225	1,343,113

Mersana Therapeutics, Inc. (5)(6)(7)(16) --

Developing treatments for cancer based on novel drug delivery polymers		Healthcare/ Biotech		
Series A Convertible Preferred Stock	(M)		68,451	136,902
Series B Convertible Preferred Stock	(M)		866,500	1,733,000
Unsecured Convertible Bridge Notes (including interest)	(M)	\$	821,975	940,231
Warrants for Series B Convertible Preferred Stock expiring 10/21/10	(I)		91,625	19,150
				2,829,283

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

	Method of Valuation (1)	Industry (2)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies				
(3)(12) –				
29.4% of net assets at value (Cont.)				
Private Placement Portfolio (Illiquid) – 29.4% of net assets at value (Cont.)				
Metabolon, Inc. (5)(6) -- Developing service and diagnostic products through the use of a metabolomics, or biochemical, profiling platform				
		Healthcare/ Biotech		
Series B Convertible Preferred Stock	(M)		371,739	\$ 1,087,608
Series B-1 Convertible Preferred Stock	(M)		148,696	435,043
Series C Convertible Preferred Stock	(M)		1,000,000	1,000,000
Warrants for Series B-1 Convertible Preferred Stock expiring 3/25/15	(I)		74,348	100,084
				2,622,735
Nextreme Thermal Solutions, Inc. (5)(6) -- Developing thin-film thermoelectric devices for cooling and energy conversion				
		Cleantech		
Series A Convertible Preferred Stock	(M)		17,500	437,500
Series B Convertible Preferred Stock	(M)		4,870,244	663,814
				1,101,314
Questech Corporation (5)(6) -- Manufacturing and marketing proprietary metal and stone products for home decoration				
		Other		
Common Stock	(M)		655,454	469,961
		Electronics/ Semi-		

SiOnyx, Inc. (5)(6)(7) -- Developing silicon-based
optoelectronic

products enabled by its proprietary Black Silicon		conductors		
Series A Convertible Preferred Stock	(M)		233,499	160,367
Series A-1 Convertible Preferred Stock	(M)		2,966,667	2,037,507
Series A-2 Convertible Preferred Stock	(M)		4,207,537	2,889,736
Series B-1 Convertible Preferred Stock	(M)		1,892,836	1,300,000
Warrants for Series B-1 Convertible Preferred				
Stock expiring 2/23/17	(I)		247,350	141,732
				6,529,342

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

	Method of Valuation (1)	Industry (2)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3)(12) – 29.4% of net assets at value (Cont.)				
Private Placement Portfolio (Illiquid) – 29.4% of net assets at value (Cont.)				
Xradia, Inc. (5)(6) -- Designing, manufacturing and selling ultra-high resolution 3D x-ray microscopes and fluorescence imaging systems		Other		
Series D Convertible Preferred Stock	(M)		3,121,099	\$ 7,365,794
Total Non-Controlled Private Placement Portfolio (cost: \$51,536,674)				\$ 40,978,655
Total Investments in Non-Controlled Affiliated Companies (cost: \$51,536,674)				\$ 40,978,655

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

	Method of Valuation (1)	Industry (2)	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (3)(17) – 6.1% of net assets at value				
Private Placement Portfolio (Illiquid) – 6.1% of net assets at value				
Ancora Pharmaceuticals Inc. (5)(6)(7) -- Developing synthetic carbohydrates for pharmaceutical applications				
		Healthcare/ Biotech		
Series B Convertible Preferred Stock	(M)		1,663,808	\$ 17,374
Series C Convertible Preferred Stock	(M)		2,066,051	1,239,632
Secured Convertible Bridge Notes (including interest)	(M)		\$ 1,500,000	1,554,948
				2,811,954
Laser Light Engines, Inc. (5)(6)(7) -- Manufacturing solid-state light sources for digital cinema and large-venue projection displays				
		Cleantech		
Series A Convertible Preferred Stock	(M)		7,499,062	2,000,000
Series B Convertible Preferred Stock	(M)		13,571,848	3,619,610
				5,619,610
Total Controlled Private Placement Portfolio (cost: \$9,380,567)				\$ 8,431,564
Total Investments in Controlled Affiliated Companies (cost: \$9,380,567)				\$ 8,431,564

Total Private Placement Portfolio (cost:
\$98,387,322) \$ 96,779,429

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
 CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
 (Unaudited)

	Method of Valuation (1)	Shares/ Principal	Value
U.S. Government Securities (18) – 31.5% of net assets at value			
U.S. Treasury Bill -- due date 10/07/10	(M)	\$ 5,600,000	\$ 5,599,888
U.S. Treasury Bill -- due date 01/13/11	(M)	38,275,000	38,260,456
Total Investments in U.S. Government Securities (cost: \$43,861,592)			
			\$ 43,860,344
Total Investments (cost: \$142,248,914)			
			\$ 140,639,773

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

Notes to Consolidated Schedule of Investments

- (1) See Footnote to Consolidated Schedule of Investments on page 28 for a description of the Valuation Procedures.
- (2) We classify Cleantech companies as those that seek to improve performance, productivity or efficiency, and to reduce environmental impact, waste, cost, energy consumption or raw materials using nanotechnology-enabled solutions. We classify Electronics/Semiconductors companies as those that use nanotechnology to address problems in electronics-related industries, including semiconductors. We classify Healthcare/Biotech companies as those that use nanotechnology to address problems in healthcare-related industries, including biotechnology, pharmaceuticals and medical devices. We use the term "Other" for companies that operate primarily in industries other than those within Cleantech, Electronics/Semiconductors and Healthcare/Biotech. These industries include photonics, metrology, test and measurement, materials, mining, decorative products and personal care products.
- (3) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company, or where we hold one or more seats on the portfolio company's Board of Directors but do not control the company. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company or otherwise control the company.
- (4) The aggregate cost for federal income tax purposes of investments in unaffiliated privately held companies is \$37,470,081. The gross unrealized appreciation based on the tax cost for these securities is \$16,674,553. The gross unrealized depreciation based on the tax cost for these securities is \$6,775,424.
- (5) We are subject to legal restrictions on the sale of this investment.
- (6) Represents a non-income producing security. Investments that have not paid dividends or interest within the last 12 months are considered to be non-income producing.
- (7) These investments are development-stage companies. A development-stage company is defined as a company that is devoting substantially all of its efforts to establishing a new business, and either it has not yet commenced its planned principal operations, or it has commenced such operations but has not realized significant revenue from them.
- (8) With our purchase of Series E Convertible Preferred Stock of BioVex, we received a warrant to purchase a number of shares of common stock of BioVex as determined by dividing 624,999.99 by the price per share at which the common stock is offered and sold to the public in connection with the initial public offering (IPO). The ability to exercise this warrant is therefore contingent on BioVex completing successfully an IPO before the expiration date of the warrant on September 27, 2012. The exercise price of this warrant shall be 110 percent of the IPO price.

The accompanying notes are an integral part of this consolidated schedule.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2010
(Unaudited)

- (9) Cobalt Technologies, Inc., also does business as Cobalt Biofuels.
- (10) On June 9, 2010, Ensemble Discovery Corporation changed its name to Ensemble Therapeutics Corporation. With our investment in a convertible bridge note issued by Ensemble Therapeutics, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of Ensemble Therapeutics equal to \$149,539.57 divided by the price per share of the class of stock sold in the next financing of Ensemble Therapeutics. The ability to exercise this warrant is, therefore, contingent on Ensemble Therapeutics completing successfully a subsequent round of financing. This warrant shall expire and no longer be exercisable on September 10, 2015. The cost basis of this warrant is \$89.86.
- (11) With our purchase of the Series B Convertible Preferred Stock of TetraVitae Bioscience, Inc., we received the right to purchase, at a price of \$2.63038528 per share, a number of shares in the Series C financing equal to the number of shares of Series B Preferred Stock purchased. The ability to exercise this right is contingent on TetraVitae Bioscience completing successfully a subsequent round of financing.
- (12) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$51,536,674. The gross unrealized appreciation based on the tax cost for these securities is \$6,024,080. The gross unrealized depreciation based on the tax cost for these securities is \$16,582,099.
- (13) Initial investment was made during 2010.
- (14) On February 28, 2008, Lifco, Inc., merged with CFX Battery, Inc. The surviving entity was CFX Battery, Inc. On February 24, 2010, CFX Battery, Inc., changed its name to Contour Energy Systems, Inc.
- (15) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through D-Wave USA, a Delaware company. Our investment is denominated in Canadian dollars and is subject to foreign currency translation. See Note 3. Summary of Significant Accounting Policies.
- (16) Warrants expired unexercised subsequent to September 30, 2010.
- (17) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$9,380,567. The gross unrealized appreciation based on the tax cost for these securities is \$523,808. The gross unrealized depreciation based on the tax cost for these securities is \$1,472,811.
- (18) The aggregate cost for federal income tax purposes of our U.S. government securities is \$43,861,592. The gross unrealized appreciation on the tax cost for these securities is \$0. The gross unrealized depreciation on the tax cost of these securities is \$1,248.

The accompanying notes are an integral part of this consolidated schedule.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3)(4) – 16.3% of net assets at value			
Private Placement Portfolio (Illiquid) – 16.1% of net assets at value			
BioVex Group, Inc. (5)(6)(7)(8) -- Developing novel biologics for treatment of cancer and infectious disease			
Series E Convertible Preferred Stock	(M)	2,799,552	\$ 1,042,862
Series G Convertible Preferred Stock	(M)	3,738,004	627,985
Warrants at \$0.21 expiring 11/5/16	(I)	285,427	20,836
			1,691,683
Cobalt Technologies, Inc. (5)(6)(7)(9) -- Developing processes for making biobutanol through biomass fermentation			
Series C Convertible Preferred Stock	(M)	352,112	375,000
D-Wave Systems, Inc. (5)(6)(7)(10) -- Developing high-performance quantum computing systems			
Series B Convertible Preferred Stock	(M)	1,144,869	907,612
Series C Convertible Preferred Stock	(M)	450,450	357,101
Series D Convertible Preferred Stock	(M)	1,533,395	1,215,622
			2,480,335
Molecular Imprints, Inc. (5)(6) -- Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(M)	1,333,333	2,999,999
Series C Convertible Preferred Stock	(M)	1,250,000	2,812,500
Warrants at \$2.00 expiring 12/31/11	(I)	125,000	163,625
			5,976,124
Nanosys, Inc. (5)(6) -- Developing zero and one-dimensional inorganic nanometer-scale materials and devices			
Series C Convertible Preferred Stock	(M)	803,428	1,185,056
Series D Convertible Preferred Stock	(M)	1,016,950	1,500,001
			2,685,057

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3)(4) – 16.3% of net assets at value (Cont.)			
Private Placement Portfolio (Illiquid) – 16.1% of net assets at value (Cont.)			
Nantero, Inc. (5)(6)(7) -- Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes			
Series A Convertible Preferred Stock	(M)	345,070	\$ 1,046,908
Series B Convertible Preferred Stock	(M)	207,051	628,172
Series C Convertible Preferred Stock	(M)	188,315	571,329
			2,246,409
NeoPhotonics Corporation (5)(6)(11) -- Developing and manufacturing optical devices and components			
Common Stock	(M)	1,100,013	739,209
Series 1 Convertible Preferred Stock	(M)	1,831,256	1,230,604
Series 2 Convertible Preferred Stock	(M)	741,898	498,555
Series 3 Convertible Preferred Stock	(M)	2,750,000	1,848,000
Series X Convertible Preferred Stock	(M)	8,923	1,427,680
Warrants at \$0.15 expiring 01/26/10	(I)	16,364	11,291
Warrants at \$0.15 expiring 12/05/10	(I)	14,063	9,703
			5,765,042
Polatis, Inc. (5)(6)(7) -- Developing MEMS-based optical networking components			
Series A-1 Convertible Preferred Stock	(M)	16,775	0
Series A-2 Convertible Preferred Stock	(M)	71,611	0
Series A-4 Convertible Preferred Stock	(M)	4,774	0
Series A-5 Convertible Preferred Stock	(M)	16,438	0
			0
PolyRemedy, Inc. (5)(6)(7) -- Developing a robotic manufacturing platform for wound treatment patches			
Series B-1 Convertible Preferred Stock	(M)	287,647	46,933
Series B-2 Convertible Preferred Stock	(M)	676,147	60,853
			107,786

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3)(4) – 16.3% of net assets at value (Cont.)			
Private Placement Portfolio (Illiquid) – 16.1% of net assets at value (Cont.)			
Siluria Technologies, Inc. (5)(6)(7) -- Developing next-generation nanomaterials			
Series S-2 Convertible Preferred Stock	(M)	612,061 \$	204,000
TetraVitae Bioscience, Inc. (5)(6)(7)(12) -- Developing methods of producing alternative chemicals and fuels through biomass fermentation			
Series B Convertible Preferred Stock	(M)	118,804	125,000
Total Unaffiliated Private Placement Portfolio (cost: \$26,977,200)			\$ 21,656,436
Publicly Traded Portfolio (Liquid) – 0.2% of net assets at value			
Orthovita, Inc. (6)(13) -- Developing materials and devices for orthopedic medical implant applications			
Common Stock	(M)	64,500	226,395
Total Unaffiliated Publicly Traded Portfolio (cost: \$298,827)			\$ 226,395
Total Investments in Unaffiliated Companies (cost: \$27,276,027)			\$ 21,882,831

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(14) – 37.5% of net assets at value			
Private Placement Portfolio (Illiquid) – 37.5% of net assets at value			
Adesto Technologies Corporation (5)(6)(7) -- Developing low-power, high-performance memory devices			
Series A Convertible Preferred Stock	(M)	6,547,619	\$ 2,420,000
Series B Convertible Preferred Stock	(M)	5,952,381	2,200,000
			4,620,000
Bridgelux, Inc. (5)(6) -- Manufacturing high-power light emitting diodes (LEDs) and arrays			
Series B Convertible Preferred Stock	(M)	1,861,504	1,804,914
Series C Convertible Preferred Stock	(M)	2,130,699	2,065,926
Series D Convertible Preferred Stock	(M)	833,333	807,999
Warrants at \$0.7136 expiring 12/31/14	(I)	163,900	98,995
Warrants at \$1.50 expiring 8/26/14	(I)	124,999	55,375
			4,833,209
Cambrios Technologies Corporation (5)(6)(7) -- Developing nanowire-enabled electronic materials for the display industry			
Series B Convertible Preferred Stock	(M)	1,294,025	647,013
Series C Convertible Preferred Stock	(M)	1,300,000	650,000
Series D Convertible Preferred Stock	(M)	515,756	257,878
			1,554,891
CFX Battery, Inc. (5)(6)(7)(15) -- Developing batteries using nanostructured materials			
Series A Convertible Preferred Stock	(M)	2,565,798	2,822,378
Series B Convertible Preferred Stock	(M)	812,500	1,300,000
			4,122,378
Crystal IS, Inc. (5)(6) -- Developing single-crystal aluminum nitride substrates for light-emitting diodes			
Common Stock	(M)	2,585,657	0
Warrants at \$0.78 expiring 05/05/13	(I)	15,231	0
Warrants at \$0.78 expiring 05/12/13	(I)	2,350	0
Warrants at \$0.78 expiring 08/08/13	(I)	4,396	0

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(14) – 37.5% of net assets at value (Cont.)			
Private Placement Portfolio (Illiquid) – 37.5% of net assets at value (Cont.)			
Ensemble Discovery Corporation (5)(6)(16) -- Developing DNA- Programmed Chemistry™ for the discovery of new classes of therapeutics and bioassays			
Series B Convertible Preferred Stock	(M)	1,449,275	\$ 1,500,000
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 299,169	325,506
			1,825,506
Enumeral Technologies, Inc. (5)(6)(7)(13) -- Developing high-value opportunities in immunology including therapeutic discovery, immune profiling and personalized medicine			
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 250,000	250,438
Innovalight, Inc. (5)(6)(7) -- Developing solar power products enabled by silicon-based nanomaterials			
Series B Convertible Preferred Stock	(M)	16,666,666	2,969,667
Series C Convertible Preferred Stock	(M)	5,810,577	1,276,457
Series D Convertible Preferred Stock	(M)	4,046,974	721,090
			4,967,214
Kovio, Inc. (5)(6) -- Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(M)	2,500,000	609,943
Series D Convertible Preferred Stock	(M)	800,000	195,182
Series E Convertible Preferred Stock	(M)	1,200,000	1,500,000
Warrants at \$1.25 expiring 12/31/12	(I)	355,880	291,466
			2,596,591
Mersana Therapeutics, Inc. (5)(6)(7) -- Developing treatments for cancer based on novel drug delivery polymers			
Series A Convertible Preferred Stock	(M)	68,451	68,451
Series B Convertible Preferred Stock	(M)	866,500	866,500
Unsecured Convertible Bridge Note (including interest)	(M)	\$ 650,000	708,165
Warrants at \$2.00 expiring 10/21/10	(I)	91,625	16,218
			1,659,334

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(14) – 37.5% of net assets at value (Cont.)			
Private Placement Portfolio (Illiquid) – 37.5% of net assets at value (Cont.)			
Metabolon, Inc. (5)(6) -- Developing service and diagnostic products through the use of a metabolomics, or biochemical, profiling platform			
Series B Convertible Preferred Stock	(M)	371,739 \$	1,034,061
Series B-1 Convertible Preferred Stock	(M)	148,696	413,625
Series C Convertible Preferred Stock	(M)	1,000,000	1,000,000
Warrants at \$1.15 expiring 3/25/15	(I)	74,348	112,092
			2,559,778
NanoGram Corporation (5)(6) -- Developing solar power products enabled by silicon-based nanomaterials			
Series I Convertible Preferred Stock	(M)	63,210	0
Series II Convertible Preferred Stock	(M)	1,250,904	0
Series III Convertible Preferred Stock	(M)	1,242,144	0
Series IV Convertible Preferred Stock	(M)	432,179	0
			0
Nextreme Thermal Solutions, Inc. (5)(6) -- Developing thin-film thermoelectric devices for cooling and energy conversion			
Series A Convertible Preferred Stock	(M)	17,500	1,750,000
Series B Convertible Preferred Stock	(M)	4,870,244	2,655,257
			4,405,257
Questech Corporation (5)(6) -- Manufacturing and marketing proprietary metal and stone decorative tiles			
Common Stock	(M)	655,454	425,390
Solazyme, Inc. (5)(6)(7) -- Developing algal biodiesel, industrial chemicals and special ingredients based on synthetic biology			
Series A Convertible Preferred Stock	(M)	988,204	4,978,157
Series B Convertible Preferred Stock	(M)	495,246	2,494,841
Series C Convertible Preferred Stock	(M)	651,309	3,281,021

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (2)(14) – 37.5% of net assets at value (Cont.)			
Private Placement Portfolio (Illiquid) – 37.5% of net assets at value (Cont.)			
Xradia, Inc. (5)(6) -- Designing, manufacturing and selling ultra-high resolution 3D x-ray microscopes and fluorescence imaging systems			
Series D Convertible Preferred Stock	(M)	3,121,099	\$ 5,723,215
Total Non-Controlled Private Placement Portfolio (cost: \$54,864,948)			\$ 50,297,220
Total Investments in Non-Controlled Affiliated Companies (cost: \$54,864,948)			\$ 50,297,220

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Controlled Affiliated Companies			
(2)(17) – 4.40% of net assets at value			
Private Placement Portfolio (Illiquid) – 4.40% of net assets at value			
Ancora Pharmaceuticals Inc. (5)(6)(7) -- Developing synthetic carbohydrates for pharmaceutical applications			
Series B Convertible Preferred Stock	(M)	1,663,808	\$ 17,374
Series C Convertible Preferred Stock	(M)	2,066,051	1,239,632
			1,257,006
Laser Light Engines, Inc. (5)(6)(7) -- Manufacturing solid-state light sources for digital cinema and large-venue projection displays			
Series A Convertible Preferred Stock	(M)	7,499,062	1,000,000
Secured Convertible Bridge Note (including interest)	(M)	\$ 1,390,000	1,434,116
			2,434,116
SiOnyx, Inc. (5)(6)(7) -- Developing silicon-based optoelectronic products enabled by its proprietary "Black Silicon"			
Series A Convertible Preferred Stock	(M)	233,499	67,843
Series A-1 Convertible Preferred Stock	(M)	2,966,667	861,965
Series A-2 Convertible Preferred Stock	(M)	4,207,537	1,222,500
			2,152,308
Total Controlled Private Placement Portfolio (cost: \$10,248,932)			
			\$ 5,843,430
Total Investments in Controlled Affiliated Companies (cost: \$10,248,932)			
			\$ 5,843,430

Total Private Placement and Publicly Traded Portfolio (cost: \$92,389,907)	\$ 78,023,481
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The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
 CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

	Method of Valuation (1)	Shares/ Principal	Value
U.S. Government Securities (18) – 41.7% of net assets at value			
U.S. Treasury Bill -- due date 04/22/10	(M)	\$ 10,000,000	\$ 9,997,600
U.S. Treasury Bill -- due date 06/17/10	(M)	42,175,000	42,139,151
U.S. Treasury Notes -- due date 02/28/10, coupon 2.000%	(M)	3,800,000	3,810,830
Total Investments in U.S. Government Securities (cost: \$55,960,024)			\$ 55,947,581
Total Investments (cost: \$148,349,931)			\$ 133,971,062

The accompanying notes are an integral part of these consolidated financial statements.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

Notes to Consolidated Schedule of Investments

- (1) See Footnote to Consolidated Schedule of Investments on page 28 for a description of the Valuation Procedures.
- (2) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company or less than five percent of the common shares of the publicly traded company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company, or where we hold one or more seats on the portfolio company's Board of Directors but do not control the company. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company or otherwise control the company.
- (3) The aggregate cost for federal income tax purposes of investments in unaffiliated privately held companies is \$26,977,200. The gross unrealized appreciation based on the tax cost for these securities is \$2,338,205. The gross unrealized depreciation based on the tax cost for these securities is \$7,658,969.
- (4) The aggregate cost for federal income tax purposes of investments in unaffiliated publicly traded companies is \$298,827. The gross unrealized appreciation based on the tax cost for these securities is \$0. The gross unrealized depreciation based on the tax cost for these securities is \$72,432.
- (5) Legal restrictions on sale of investment.
- (6) Represents a non-income producing security. Equity investments that have not paid dividends within the last 12 months are considered to be non-income producing.
- (7) These investments are development-stage companies. A development-stage company is defined as a company that is devoting substantially all of its efforts to establishing a new business, and either it has not yet commenced its planned principal operations, or it has commenced such operations but has not realized significant revenue from them.
- (8) With our purchase of Series E Convertible Preferred Stock of BioVex, we received a warrant to purchase a number of shares of common stock of BioVex as determined by dividing 624,999.99 by the price per share at which the common stock is offered and sold to the public in connection with the IPO. The ability to exercise this warrant is therefore contingent on BioVex completing successfully an IPO before the expiration date of the warrant on September 27, 2012. The exercise price of this warrant shall be 110 percent of the IPO price.
- (9) Cobalt Technologies, Inc., does business as Cobalt Biofuels.
- (10) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through D-Wave USA, a Delaware company. Our investment is denominated in Canadian dollars and is subject to foreign currency translation. See "Note 3. Summary of Significant Accounting Policies."
- (11) We exercised NeoPhotonics Corporation warrants in January and February 2010.

The accompanying notes are an integral part of this consolidated schedule.

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2009

- (12) With our purchase of the Series B Convertible Preferred Stock of TetraVita Bioscience, Inc., we received the right to purchase, at a price of \$2.63038528 per share, a number of shares in the Series C financing equal to the number of shares of Series B Preferred Stock purchased. The ability to exercise this right is contingent on TetraVita Bioscience completing successfully a subsequent round of financing.
- (13) Initial investment was made during 2009.
- (14) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$54,864,948. The gross unrealized appreciation based on the tax cost for these securities is \$10,648,525. The gross unrealized depreciation based on the tax cost for these securities is \$15,216,253.
- (15) On February 28, 2008, Lifco, Inc., merged with CFX Battery, Inc. The surviving entity is CFX Battery, Inc.
- (16) With our investment in a convertible bridge note issued by Ensemble Discovery, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of Ensemble Discovery equal to \$149,539.57 divided by the price per share of the class of stock sold in the next financing of Ensemble Discovery. The ability to exercise this warrant is, therefore, contingent on Ensemble Discovery completing successfully a subsequent round of financing. This warrant shall expire and no longer be exercisable on September 10, 2015. The cost basis of this warrant is \$89.86.
- (17) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$10,248,932. The gross unrealized appreciation based on the tax cost for these securities is \$0. The gross unrealized depreciation based on the tax cost for these securities is \$4,405,502.
- (18) The aggregate cost for federal income tax purposes of our U.S. government securities is \$55,960,024. The gross unrealized appreciation on the tax cost for these securities is \$0. The gross unrealized depreciation on the tax cost of these securities is \$12,443.

The accompanying notes are an integral part of this consolidated schedule.

HARRIS & HARRIS GROUP, INC.
FOOTNOTE TO CONSOLIDATED SCHEDULE OF INVESTMENTS

VALUATION PROCEDURES

I. Determination of Net Asset Value

The 1940 Act requires periodic valuation of each investment in the portfolio of the Company to determine its net asset value ("NAV"). Under the 1940 Act, unrestricted securities with readily available market quotations are to be valued at the current market value; all other assets must be valued at "fair value" as determined in good faith by or under the direction of the Board of Directors.

The Board of Directors is responsible for (1) determining overall valuation guidelines and (2) ensuring that the investments of the Company are valued within the prescribed guidelines.

The Valuation Committee, comprised of all of the independent Board members, is responsible for determining the valuation of the Company's assets within the guidelines established by the Board of Directors. The Valuation Committee receives information and recommendations from management.

The values assigned to these investments are based on available information and do not necessarily represent amounts that might ultimately be realized when that investment is sold, as such amounts depend on future circumstances and cannot reasonably be determined until the individual investments are actually liquidated or become readily marketable.

II. Approaches to Determining Fair Value

Accounting principles generally accepted in the United States of America ("GAAP") define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). In effect, GAAP applies fair value terminology to all valuations whereas the 1940 Act applies market value terminology to readily marketable assets and fair value terminology to other assets.

The main approaches to measuring fair value utilized are the market approach and the income approach.

- **Market Approach (M):** The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. For example, the market approach often uses market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range each appropriate multiple falls requires judgment considering factors specific to the measurement (qualitative and quantitative).

- **Income Approach (I):** The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Those valuation techniques include present value techniques; option-pricing models, such as the Black-Scholes-Merton formula (a closed-form model) and a binomial model (a lattice model), which incorporate present value techniques; and the multi-period excess earnings method, which is used to measure the fair value of certain assets.

GAAP classifies the inputs used to measure fair value by these approaches into the following hierarchy:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.
 - Level 2: Quoted