

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

Edgar Filing: HARRIS & HARRIS GROUP INC /NY/ - Form 10-Q

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

	Page Number
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Consolidated Financial Statements	1
Consolidated Statements of Assets and Liabilities	2
Consolidated Statements of Operations	3
Consolidated Statements of Cash Flows	4
Consolidated Statements of Changes in Net Assets	5
Consolidated Schedule of Investments	6
Notes to Consolidated Financial Statements	32
Financial Highlights	43
Item 2. Management's Discussion and Analysis of Financial Condition	
and Results of Operations	44
Background and Overview	44
Investment Strategy	45
Historical Investments	45
Investment Pace	46
Importance of Availability of Liquid Capital	46
Involvement with Portfolio Companies	48
Commercialization of Nanotechnology by Our Portfolio Companies	48
Maturity of Current Venture Capital Portfolio	51
Current Business Environment	54
Valuation of Investments	55
Investment Objective	59
Results of Operations	60
Financial Condition	68
Liquidity	70
Capital Resources	71
Critical Accounting Policies	71
Recent Developments – Portfolio Companies	74

Forward-Looking Statements	74
Item 3. Quantitative and Qualitative Disclosures About Market Risk	75
Item 4. Controls and Procedures	77
PART II. OTHER INFORMATION	
Item 1A. Risk Factors	78
Item 5. Exhibits	79
Signatures	80
Exhibit Index	81

---

## 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
<b>Investments, in portfolio securities at value:</b>		
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
<b>Total assets</b>	<b>\$ 141,630,221</b>	<b>\$ 136,109,101</b>

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
<b>Total liabilities</b>	<b>2,349,711</b>	<b>1,950,843</b>
<b>Net assets</b>	<b>\$ 139,280,510</b>	<b>\$ 134,158,258</b>
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
<b>Investment income:</b>				
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
<b>Total investment income</b>	<b>140,445</b>	<b>105,677</b>	<b>348,726</b>	<b>165,950</b>
<b>Expenses:</b>				
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
<b>Total expenses</b>	<b>1,909,309</b>	<b>2,348,630</b>	<b>6,184,217</b>	<b>6,506,053</b>
<b>Net operating loss</b>	<b>(1,768,864)</b>	<b>(2,242,953)</b>	<b>(5,835,491)</b>	<b>(6,340,103)</b>
<b>Net realized gain (loss):</b>				
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)
<b>Realized loss from investments</b>	<b>(3,136,863)</b>	<b>(3,176,125)</b>	<b>(3,545,155)</b>	<b>(4,690,780)</b>
Income tax expense (benefit) (Note 7)	1,799	(2,862)	4,431	(753)
<b>Net realized loss</b>	<b>(3,138,662)</b>	<b>(3,173,263)</b>	<b>(3,549,586)</b>	<b>(4,690,027)</b>
<b>Net decrease in unrealized depreciation on investments:</b>				
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
<b>Net decrease in unrealized depreciation on investments</b>	<b>4,453,494</b>	<b>5,119,897</b>	<b>12,769,728</b>	<b>10,203,754</b>
<b>Net (decrease) increase in net assets resulting from operations</b>	<b>\$ (454,032)</b>	<b>\$ (296,319)</b>	<b>\$ 3,384,651</b>	<b>\$ (826,376)</b>



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
<b>Cash flows used in operating activities:</b>		
Net increase (decrease) in net assets resulting from operations	\$ 3,384,651	\$ (826,376)
<b>Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash used in operating activities:</b>		
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
<b>Changes in assets and liabilities:</b>		
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)
<b>Net cash used in operating activities</b>	<b>(4,105,170)</b>	<b>(3,748,258)</b>
<b>Cash flows from investing activities:</b>		
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)
<b>Net cash provided by investing activities</b>	<b>2,758,941</b>	<b>4,149,975</b>
<b>Cash flows from financing activities:</b>		
Proceeds from stock option exercises	39,795	401,944
Payment of offering costs	(48,928)	0
<b>Net cash (used in) provided by financing activities</b>	<b>(9,133)</b>	<b>401,944</b>

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
<b>Changes in net assets from operations:</b>		
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
<b>Net increase (decrease) in net assets resulting from operations</b>	<b>3,384,651</b>	<b>(148,465)</b>
<b>Changes in net assets from capital stock transactions:</b>		
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
<b>Net increase in net assets resulting from capital stock transactions</b>	<b>1,737,601</b>	<b>24,775,610</b>
<b>Net increase in net assets</b>	<b>5,122,252</b>	<b>24,627,145</b>
<b>Net assets:</b>		
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.)				
Molecular Imprints, Inc. (5)(6) -- Manufacturing nanoimprint lithography capital equipment		Electronics/ 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
Nanosys, Inc. (5)(6) -- Developing inorganic nanowires and quantum dots for use in batteries and LED-backlit devices				
		Cleantech		
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
Nantero, Inc. (5)(6)(7) -- Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes				
		Electronics/ 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
NeoPhotonics Corporation (5)(6) -- Developing and manufacturing				
		Other		



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

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.)				
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
--	---------------

Total Investments in Unaffiliated Companies (cost: \$37,470,081)	\$ 47,369,210
---	---------------

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

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.)				
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
--	---------------

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 prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
  - Level 3: Unobservable inputs for the asset or liability.

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

### III. Investment Categories

The Company's investments can be classified into five broad categories for valuation purposes:

- Equity-related securities;
- Long-term fixed-income securities;
- Short-term fixed-income securities;
- Investments in intellectual property, patents, research and development in technology or product development; and
- All other securities.

The Company applies the methods for determining fair value discussed above to the valuation of investments in each of these five broad categories as follows:

#### A. EQUITY-RELATED SECURITIES

Equity-related securities, including warrants, are fair valued using the market or income approaches. The following factors may be considered when the market approach is used to fair value these types of securities:

§ Readily available public market quotations;

§ The cost of the Company's investment;

§ Transactions in a company's securities or unconditional firm offers by responsible parties as a factor in determining valuation;

§ The financial condition and operating results of the company;

§ The company's progress towards milestones.

§ The long-term potential of the business and technology of the company;

§ The values of similar securities issued by companies in similar businesses;

§ Multiples to revenue, net income or EBITDA that similar securities issued by companies in similar businesses receive;

§ The proportion of the company's securities we own and the nature of any rights to require the company to register restricted securities under applicable securities laws; and

§ The rights and preferences of the class of securities we own as compared with other classes of securities the portfolio company has issued.

When the income approach is used to value warrants, the Company uses the Black-Scholes-Merton formula.

## B. LONG-TERM FIXED-INCOME SECURITIES

1. Readily Marketable: Long-term fixed-income securities for which market quotations are readily available are valued using the most recent bid quotations when available.

2. Not Readily Marketable: Long-term fixed-income securities for which market quotations are not readily available are fair valued using the income approach. The factors that may be considered when valuing these types of securities by the income approach include:

- Credit quality;
- Interest rate analysis;
- Quotations from broker-dealers;
- Prices from independent pricing services that the Board believes are reasonably reliable; and
- Reasonable price discovery procedures and data from other sources.

C. SHORT-TERM FIXED-INCOME SECURITIES

Short-term fixed-income securities are valued using the market approach in the same manner as long-term fixed-income securities until the remaining maturity is 60 days or less, after which time such securities may be valued at amortized cost if there is no concern over payment at maturity.

D. INVESTMENTS IN INTELLECTUAL PROPERTY, PATENTS, RESEARCH AND DEVELOPMENT IN TECHNOLOGY OR PRODUCT DEVELOPMENT

Such investments are fair valued using the market approach. The Company may consider factors specific to these types of investments when using the market approach including:

- Investments in the same or substantially similar intellectual property or patents or research and development in technology or product development or offers by responsible third parties;
  - The cost of the Company's investment;
  - The results of research and development;
  - Product development and milestone progress;
    - Commercial prospects;
    - Term of patent;
    - Projected markets; and
    - Other subjective factors.

E. ALL OTHER SECURITIES

All other securities are reported at fair value as determined in good faith by the Valuation Committee using the approaches for determining valuation as described above.

For all other securities, the reported values shall reflect the Valuation Committee's judgment of fair values as of the valuation date using the outlined basic approaches of valuation discussed in Section III. They do not necessarily represent an amount of money that would be realized if we had to sell such assets in an immediate liquidation. Thus, valuations as of any particular date are not necessarily indicative of amounts that we may ultimately realize as a result of future sales or other dispositions of investments we hold.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

NOTE 1. THE COMPANY

Harris & Harris Group, Inc. (the "Company," "us," "our" and "we"), is a venture capital company operating as a business development company ("BDC") under the Investment Company Act of 1940 (the "1940 Act") that specializes in making investments in companies commercializing and integrating products enabled by nanotechnology and microsystems. We operate as an internally managed company whereby our officers and employees, under the general supervision of our Board of Directors, conduct our operations.

Harris & Harris Enterprises, Inc.<sup>SM</sup>, is a 100 percent wholly owned subsidiary of the Company. Harris & Harris Enterprises, Inc., is a partner in Harris Partners I, L.P. <sup>SM</sup>, and is taxed under Subchapter C of the Code (a "C Corporation"). Harris Partners I, L.P. is a limited partnership and, from time to time, may be used to hold certain interests in portfolio companies. The partners of Harris Partners I, L.P., are Harris & Harris Enterprises, Inc., (sole general partner) and Harris & Harris Group, Inc. (sole limited partner). Harris & Harris Enterprises, Inc., pays taxes on any non-passive investment income generated by Harris Partners I, L.P. For the period ended September 30, 2010, there was no non-passive investment income generated by Harris Partners I, L.P. The Company consolidates the results of its subsidiaries for financial reporting purposes.

NOTE 2. INTERIM FINANCIAL STATEMENTS

Our interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and in conformity with accounting principles generally accepted in the United States of America ("GAAP") applicable to interim financial information. 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. In the opinion of management, these financial statements reflect all adjustments, consisting of valuation adjustments and normal recurring accruals, necessary for a fair presentation of our financial position, results of operations and cash flows for such periods. The results of operations for any interim period are not necessarily indicative of the results for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies followed in the preparation of the consolidated financial statements:

**Principles of Consolidation.** The consolidated financial statements have been prepared in accordance with GAAP and include the accounts of the Company and its wholly owned subsidiary. All significant inter-company accounts and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current period presentation.





**Use of Estimates.** The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from these estimates, and the differences could be material. The most significant estimates relate to the fair valuations of our investments.

**Cash and Cash Equivalents.** Cash and cash equivalents includes demand deposits. Cash and cash equivalents are carried at cost which approximates value.

**Portfolio Investment Valuations.** Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the Securities and Exchange Commission ("SEC") and in accordance with GAAP. 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) the fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments.") At September 30, 2010, our financial statements include privately held venture capital investments valued at \$96,779,429. The fair values of our private venture capital investments were determined in good faith by, or under the direction, of the Board of Directors. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. The difference could be material.

**Foreign Currency Translation.** The accounting records of the Company are maintained in U.S. dollars. All assets and liabilities denominated in foreign currencies are translated into U.S. dollars based on the rate of exchange of such currencies against U.S. dollars on the date of valuation. For the nine months ended September 30, 2010, included in the net decrease in unrealized depreciation on investments was a \$46,860 unrealized gain resulting from foreign currency translation.

**Securities Transactions.** Securities transactions are accounted for on the date the transaction for the purchase or sale of the securities is entered into by the Company (i.e., trade date).

**Interest Income Recognition.** Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. When securities are determined to be non-income producing, the Company ceases accruing interest and writes off any previously accrued interest. During the three months and nine months ended September 30, 2010, the Company earned \$15,327 and \$38,161, respectively, in interest on U.S. government securities, participation agreements and interest-bearing accounts. During the three months and nine months ended September 30, 2010, the Company recorded \$118,770 and \$292,217, respectively, of bridge note interest.

**Loan Origination Fees.** Upfront loan origination fees received in connection with investments are capitalized. The unearned fee income is accreted into income based on the effective interest method over the life of the investment.

**Realized Gain or Loss and Unrealized Appreciation or Depreciation of Portfolio Investments.** Realized gain or loss is recognized when an investment is disposed of and is computed as the difference between the Company's cost basis in the investment at the disposition date and the net proceeds received from such disposition. Realized gains and losses on investment transactions are determined by specific identification. Unrealized appreciation or depreciation is computed as the difference between the fair value of the investment and the cost basis of such investment.

**Stock-Based Compensation.** The Company has a stock-based employee compensation plan. The Company accounts for the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan") by determining the fair value of all share-based payments to employees, including the fair value of grants of employee stock options, and records these amounts as an expense in the Consolidated Statements of Operations over the vesting period with a corresponding increase to our additional paid-in capital. At September 30, 2010, and December 31, 2009, the increase to our operating expenses was offset by the increase to our additional paid-in capital, resulting in no net impact to our NAV. Additionally, the Company does not record the tax benefits associated with the expensing of stock options, because the Company currently intends to qualify as a RIC under Subchapter M of the Code. The amount of non-cash, stock-based compensation expense recognized in the Consolidated Statements of Operations is based on the fair value of the awards the Company expects to vest, recognized over the vesting period on a straight-line basis for each award, and adjusted for actual options vested and pre-vesting forfeitures. The forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if the actual forfeiture rate differs from the estimated rate and is accounted for in the current period and prospectively. See "Note 6. Stock-Based Compensation" for further discussion.

**Income Taxes.** As we intend to qualify as a RIC under Subchapter M of the Internal Revenue Code, the Company does not provide for income taxes. The Company recognizes interest and penalties in income tax expense.

We pay federal, state and local income taxes on behalf of our wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is a C corporation. See "Note 7. Income Taxes."

**Restricted Funds.** At September 30, 2010, and December 31, 2009, we held \$2,001 and \$2,000, respectively, in restricted funds as a security deposit for a sublessor.

**Property and Equipment.** Property and equipment are included in "Other Assets" and are carried at \$371,084 and \$69,528 at September 30, 2010, and December 31, 2009, respectively, representing cost, less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the premises and equipment. We estimate the useful lives to be five to ten years for furniture and fixtures, three years for computer equipment, and ten years for leasehold improvements.

**Rent expense.** Our lease at 1450 Broadway, New York, New York, commenced on January 21, 2010. The lease expires on December 31, 2019. The base rent is \$36 per square foot with a 2.5 percent increase per year over the 10 years of the lease, subject to a full abatement of rent for four months and a rent credit for six months throughout the lease term. Certain leasehold improvements were also paid for on our behalf by the landlord, the cost of which is accounted for as property and equipment and deferred rent in the accompanying Consolidated Statements of Assets and Liabilities. These leasehold improvements are depreciated over the lease term. We apply these rent abatements, credits and escalations on a straight-line basis in the determination of rent expense over the lease term.

**Lease Termination Costs.** During the nine months ended September 30, 2010, we recognized a loss of \$68,038 for costs associated with vacating our offices at 111 West 57th Street, New York, New York, prior to the end of our lease in April 2010.

**Post Retirement Plan Liabilities.** Unrecognized actuarial gains and losses are recognized as net periodic benefit cost pursuant to the Company's historical accounting policy for amortizing such amounts. Actuarial gains and losses that arise that are not recognized as net periodic benefit cost in the same periods will be recognized as a component of net assets.

**Concentration of Credit Risk.** The Company places its cash and cash equivalents with financial institutions and, at times, cash held in checking accounts may exceed the Federal Deposit Insurance Corporation insured limit.

**Recent Accounting Pronouncements.** In January 2010, the FASB issued Accounting Standards Update No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures about Fair Value Measurements. This guidance requires reporting entities to make new disclosures about recurring and nonrecurring fair value measurements, including significant transfers into and out of Level 1 and Level 2 fair value measurements, and information on purchases, sales, issuances and settlements, on a gross basis, in the reconciliation of Level 3 fair value measurements. This guidance also requires disclosure of fair value measurements by "class" instead of by "major category" as well as any changes in valuation techniques used during the reporting period. For disclosures of Level 1 and Level 2 activity, fair value measurements by "class" and changes in valuation techniques, this guidance was effective for interim and annual reporting periods beginning after December 15, 2009, with disclosures for previous comparative periods prior to adoption not required. The adoption of this portion of the guidance on January 1, 2010, did not have a material impact on the Company's disclosures. For the reconciliation of Level 3 fair value measurements, this guidance is effective for interim and annual reporting periods beginning after December 15, 2010. The adoption of this portion of the guidance is not expected to have a material impact on the Company's disclosures.

#### NOTE 4. BUSINESS RISKS AND UNCERTAINTIES

We have invested a substantial portion of our assets in privately held companies, the securities of which are inherently illiquid. We also seek to invest in small publicly traded companies that we believe have exceptional growth potential. Although these companies are publicly traded, their stock may not trade at high volumes and prices can be volatile, which may restrict our ability to sell our positions. These privately held and publicly traded businesses tend to lack management depth, to have limited or no history of operations and to not have attained profitability. Because of the speculative nature of our investments and the lack of a public market for privately held investments, there is greater risk of loss than is the case with traditional investment securities.

We do not choose investments based on a strategy of diversification. We also do not rebalance the portfolio should one of our portfolio companies increase in value substantially relative to the rest of the portfolio. Therefore, the value of our portfolio may be more vulnerable to events affecting a single sector, industry or portfolio company and, therefore, subject to greater volatility than a company that follows a diversification strategy. As of September 30, 2010, our largest ten investments by value accounted for approximately 71 percent of the value of our venture capital portfolio. Our largest investment, by value, accounted for approximately 21 percent of our venture capital portfolio at September 30, 2010.

Because there is typically no public or readily ascertainable market for our interests in the small privately held companies in which we invest, the valuation of the equity, bridge note and participation agreement interests in that portion of our portfolio is determined in good faith by our Valuation Committee, comprised of all of the independent members of our Board of Directors, in accordance with our Valuation Procedures and is subject to significant estimates and judgments. The determined value of our portfolio of equity interests, bridge notes and participation agreements may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests, bridge notes and participation agreements existed. Any changes in valuation are recorded in our Consolidated Statements of Operations as "Net decrease (increase) in unrealized depreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

#### NOTE 5. INVESTMENTS

At September 30, 2010, our financial assets were categorized as follows in the fair value hierarchy:

Description	Fair Value Measurement at Reporting Date Using:			
	September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government Securities	\$ 43,860,344	\$ 43,860,344	\$ 0	\$ 0
<b>Privately Held Portfolio Companies:</b>				
Preferred Stock	\$ 90,589,489	\$ 0	\$ 0	\$ 90,589,489
Bridge Notes	\$ 3,716,174	\$ 0	\$ 0	\$ 3,716,174
Common Stock	\$ 1,401,444	\$ 0	\$ 0	\$ 1,401,444
Warrants	\$ 581,922	\$ 0	\$ 0	\$ 581,922
Participation Agreement	\$ 490,400			\$ 490,400
<b>Publicly Traded Portfolio Companies:</b>				
Common Stock	\$ 0	\$ 0	\$ 0	\$ 0
<b>Total</b>	<b>\$ 140,639,773</b>	<b>\$ 43,860,344</b>	<b>\$ 0</b>	<b>\$ 96,779,429</b>

The following chart shows the components of change in the financial assets categorized as Level 3 for the three months ended September 30, 2010.

	Beginning Balance 7/1/2010	Total Realized Losses Included in Changes in Net Assets	Total Unrealized Gains (Losses) Included in Changes in Net Assets	Investments in Private Placements and Interest on Bridge Notes, Net	Disposals	Ending Balance 9/30/2010	Amount of Total Gains for the Period Included in Changes in Net Assets Attributable to the Change in Unrealized Gains or Losses Relating to Assets Still Held at the Reporting Date
Preferred Stock	\$ 85,717,686	\$ (3,136,552)	\$ 4,092,902	\$ 3,915,453	\$ 0	\$ 90,589,489	\$ 956,350
Bridge Notes	4,658,791	0	112,804	(1,055,420)	0	3,716,175	112,804
Common Stock	1,122,777	0	278,667	0	0	1,401,444	278,667
Warrants	540,743	0	(57,465)	98,643	0	581,921	(57,465)
Participation Agreement	0	0	10,052	480,348	0	490,400	10,052
Total	\$ 92,039,997	\$ (3,136,552)	\$ 4,436,960	\$ 3,439,024	\$ 0	\$ 96,779,429	\$ 1,300,408

The following chart shows the components of change in the financial assets categorized as Level 3 for the nine months ended September 30, 2010.

Beginning Balance 1/1/2010	Total Realized Losses Included in Changes in Net Assets	Total Unrealized Gains (Losses) Included in Changes in Net Assets	Investments in Private Placements and Interest on Bridge Notes, Net	Disposals	Ending Balance 9/30/2010	Amount of Total Gains for the Period Included in Changes in Net Assets Attributable to the Change in Unrealized Gains or Losses Relating to
----------------------------------	--	---	--	-----------	--------------------------------	---

Assets Still Held  
at the  
Reporting Date

Preferred Stock	\$ 73,134,661	\$ (3,136,552)	\$ 12,410,293	\$ 8,181,087	\$ 0	\$ 90,589,489	\$ 9,273,741
Bridge Notes	2,718,225	0	112,804	885,146	0	3,716,175	112,804
Common Stock	1,164,599	0	227,967	8,878	0	1,401,444	227,967
Warrants	779,601	(257,007)	(75,015)	134,342	0	581,921	(75,015)
Participation Agreement	0	0	10,052	480,348	0	490,400	10,052
Total	\$ 77,797,086	\$ (3,393,559)	\$ 12,686,101	\$ 9,689,801	\$ 0	\$ 96,779,429	\$ 9,549,549

At December 31, 2009, our financial assets were categorized as follows in the fair value hierarchy:

## Fair Value Measurement at Reporting Date Using:

Description	December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government Securities	\$ 55,947,581	\$ 52,136,751	\$ 3,810,830	\$ 0
<b>Privately Held Portfolio Companies:</b>				
Preferred Stock	\$ 73,134,661	\$ 0	\$ 0	\$ 73,134,661
Bridge Notes	\$ 2,718,225	\$ 0	\$ 0	\$ 2,718,225
Common Stock	\$ 1,164,599	\$ 0	\$ 0	\$ 1,164,599
Warrants	\$ 779,601	\$ 0	\$ 0	\$ 779,601
	\$ 77,797,086			
<b>Publicly Traded Portfolio Companies</b>				
Portfolio Companies	\$ 226,395	\$ 226,395	\$ 0	\$ 0
<b>Total</b>	<b>\$ 133,971,062</b>	<b>\$ 52,363,146</b>	<b>\$ 3,810,830</b>	<b>\$ 77,797,086</b>

The following chart shows the components of change in the financial assets categorized as Level 3, for the twelve months ended December 31, 2009.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
<b>Portfolio Companies</b>	
Beginning Balance, January 1, 2009	\$ 56,965,153
Total realized losses included in change in net assets	(11,106,005)
Total unrealized gains included in change in net assets	19,830,852
Investments in private placements and interest on bridge notes	12,212,789
Disposals and write-offs of bridge note interest	(105,703)
Ending Balance, December 31, 2009	\$ 77,797,086



The amount of total gains for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	\$	8,786,290
---	----	-----------

#### NOTE 6. STOCK-BASED COMPENSATION

On March 18, 2010, and May 12, 2010, the Compensation Committee of the Board of Directors and the full Board of Directors of the Company approved grants of individual Non-Qualified Stock Option ("NQSO") awards for certain officers and employees of the Company. The terms and conditions of the stock options granted were set forth in award agreements between the Company and each award recipient entered into on those dates. Options to purchase a total of 150,000 shares of stock were granted on March 18, 2010, with vesting periods ranging from March 18, 2011, to March 18, 2013, and with an exercise price of \$4.75, which was the closing price of our shares of common stock as quoted on the Nasdaq Global Market on March 18, 2010. Options to purchase a total of 150,000 shares of stock were granted on May 12, 2010, with vesting periods ranging from May 12, 2011, to May 12, 2013, and with an exercise price of \$4.84, which was the closing price of our shares of common stock as quoted on the Nasdaq Global Market on May 12, 2010. The awards may become fully vested and exercisable prior to the date or dates in the vesting schedule if the Board of Directors accepts an offer for the sale of all or substantially all of the Company's assets. Upon exercise, the shares would be issued from our previously authorized but unissued shares.

The fair value of the options was determined on the date of grant using the Black-Scholes-Merton model.

The assumptions used in the calculation of fair value of the NQSOs granted on March 18, 2010, and May 12, 2010, using the Black-Scholes-Merton model for the expected term was as follows:

Type of Award	Term	Number of Options Granted	Expected Term in Yrs	Expected Volatility Factor	Expected Dividend Yield	Risk-Free Interest Rates	Weighted Average Fair Value Per Share
<b>March 18, 2010</b>							
Non-qualified stock options	5 Years	150,000	3.50	63.1%	0%	1.77%	\$2.20
<b>May 12, 2010</b>							
Non-qualified stock options	5 Years	150,000	3.50	62.3%	0%	1.64%	\$2.21
<b>Total</b>		<b>300,000</b>					<b>\$2.21</b>

For the three months and nine months ended September 30, 2010, the Company recognized \$531,795 and \$1,746,734 of compensation expense in the Consolidated Statements of Operations. As of September 30, 2010, there was approximately \$4,956,008 of unrecognized compensation cost related to unvested stock option awards. This cost is expected to be recognized over a weighted average period of approximately 1.5 years.

For the three months ended September 30, 2010, a total of 5,306 options were exercised for total proceeds to the Company of \$19,898. For the nine months ended September 30, 2010, a total of 10,612 options were exercised for total proceeds to the Company of \$39,795.

A summary of the changes in outstanding stock options for the nine months ended September 30, 2010, is as follows:

		Weighted Average			
	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Remaining Contractual Term (Yrs)	Aggregate Intrinsic Value
Options Outstanding at January 1, 2010	4,184,503	\$8.20	\$4.79	6.24	\$216,333
Granted	300,000	\$4.80	\$2.21	4.54	
Exercised	(10,612)	\$3.75	\$1.29		
Forfeited or Expired	(3,245)	\$4.82	\$2.24		
Options Outstanding at September 30, 2010	4,470,646	\$7.98	\$4.63	5.44	\$ 107,571
Options Exercisable at September 30, 2010	2,934,598	\$8.61	\$4.96	5.11	\$ 107,571
Options Exercisable and Expected to be Exercisable at September 30, 2010	4,178,811	\$8.05	\$4.67	5.39	\$ 107,571

The aggregate intrinsic value in the table above with respect to options outstanding, exercisable and expected to be exercisable, is calculated as the difference between the Company's closing stock price of \$4.27 on the last trading day of the third quarter of 2010 and the exercise price, multiplied by the number of in-the-money options. This amount represents the total pre-tax intrinsic value that would have been received by the option holders had all options been fully vested and all option holders exercised their awards on September 30, 2010. The intrinsic value on the dates of exercise of 10,612 options exercised during the nine months ended September 30, 2010, was \$8,521.

On June 2, 2010, the Company announced that its Compensation Committee has cancelled its previously scheduled meetings for the purpose of awarding stock options pursuant to the Stock Plan in 2010, and it will not award stock options for at least one year from the date of the announcement. The Compensation Committee also decided that any future grants of options, if they occur, will not be awarded at a price below NAV per share.

#### NOTE 7. INCOME TAXES

We have elected to be treated as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code") and operate in a manner so as to qualify for the tax treatment applicable to RICs.

In order to qualify as a RIC, we must, in general, (1) annually, derive at least 90 percent of our gross income from dividends, interest, gains from the sale of securities and similar sources; (2) quarterly, meet certain investment diversification requirements; and (3) annually, distribute at least 90 percent of our investment company taxable

income as a dividend. We may either distribute or retain our net capital gain from investments, but any net capital gain not distributed will be subject to corporate income tax and the excise tax described below. We will be subject to a four percent excise tax to the extent we fail to distribute at least 98 percent of our annual net ordinary income and 98 percent of our capital gain net income and would be subject to income tax to the extent we fail to distribute 100 percent of our investment company taxable income.

Because of the specialized nature of our investment portfolio, we generally can satisfy the diversification requirements under the Code if we receive a certification from the SEC that we are "principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available."

On May 28, 2010, we received SEC certification for 2009, permitting us to qualify for RIC treatment for 2009 (as we had for the years 1999 through 2008) pursuant to Section 851(e) of the Code. Although the SEC certification for 2009 was issued, there can be no assurance that we will qualify for or receive such certification for subsequent years (to the extent we need additional certification as a result of changes in our portfolio) or that we will actually qualify for Subchapter M treatment in subsequent years. We qualified for RIC treatment in 2009 even without certification. In addition, under certain circumstances, even if we qualified for Subchapter M treatment in a given year, we might take action in a subsequent year to ensure that we would be taxed in that subsequent year as a C Corporation, rather than as a RIC. Because Subchapter M does not permit deduction of operating expenses against net capital gain, it is not clear that the Company and its shareholders have paid less in taxes since 1999 than they would have paid had the Company remained a C Corporation.

For the nine months ended September 30, 2010, we paid \$4,431 in state and local income and franchise taxes. During the third quarter of 2010, we paid \$1,799 in state franchise taxes. At September 30, 2010, we had \$0 accrued for federal, state and local taxes payable by the Company.

We pay federal, state and local taxes on behalf of our wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is taxed as a C Corporation. For the three months ended September 30, 2010, and 2009, our income tax expense (benefit) for Harris & Harris Enterprises, Inc., was \$0 and \$(2,960), respectively. For the nine months ended September 30, 2010, and 2009, our income tax expense (benefit) for Harris & Harris Enterprises, Inc., was \$2,527 and \$(2,960), respectively.

#### NOTE 8. CAPITAL TRANSACTIONS

On October 9, 2009, we closed a public follow-on offering of 4,887,500 shares of our common stock at a price of \$4.75 per share to the public. The net proceeds of this offering, after deducting underwriting discounts and offering costs of \$2,000,413, were \$21,215,212.

#### NOTE 9. CHANGE IN NET ASSETS PER SHARE

The following table sets forth the computation of basic and diluted per share net (decreases) increases in net assets resulting from operations for the three months and nine months ended September 30, 2010, and September 30, 2009.

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2010	2009	2010	2009
Numerator for (decrease) increase in net assets per share	\$(454,032)	\$(296,319)	\$3,384,651	\$(826,376)
Denominator for basic weighted average shares	30,866,399	25,866,983	30,863,616	25,862,070
Basic net (decrease) increase in net assets per share resulting from operations	\$(0.01)	\$(0.01)	\$0.11	\$(0.03)
Denominator for diluted weighted average shares	30,866,399	25,866,983	30,895,197	25,862,070
Diluted net (decrease) increase in net assets per share resulting from operations	\$(0.01)	\$(0.01)	\$0.11	\$(0.03)

For the nine months ended September 30, 2010, the calculation of net increase in net assets resulting from operations per diluted share includes 31,581 stock options from the March 2009 grant because such options were dilutive. All other options granted in the period from June 2006 through May 2010 were anti-dilutive. Stock options may be dilutive in future periods in which there is a net increase in net assets resulting from operations, or in the event that there are significant increases in the average stock price in the stock market or significant decreases in the amount of unrecognized compensation cost.

#### NOTE 10. SUBSEQUENT EVENTS

On October 27, 2010, we made a \$300,000 follow-on investment in a privately held tiny technology portfolio company.

HARRIS & HARRIS GROUP, INC.  
FINANCIAL HIGHLIGHTS  
(Unaudited)

	Three Months Ended Sept. 30		Nine Months Ended Sept. 30	
	2010	2009	2010	2009
<b>Per Share Operating Performance</b>				
Net asset value per share, beginning of period	\$ 4.51	\$ 4.27	\$ 4.35	\$ 4.24
Net operating (loss)*	(0.05)	(0.08)	(0.19)	(0.25)
Net realized (loss) on investments*(1)	(0.10)	(0.12)	(0.11)	(0.18)
Net decrease in unrealized depreciation as a result of sales*(1)	0.10	0.12	0.11	0.18
Net decrease (increase) in unrealized depreciation on investments held*	0.04	0.07	0.30	0.21
Total from investment operations*	(0.01)	(0.01)	0.11	(0.04)
Net increase as a result of stock-based compensation expense*	0.01	0.03	0.05	0.09
Net increase as a result of proceeds from exercise of options	0.00	0.01	0.00	0.01
Total increase from capital stock transactions	0.01	0.04	0.05	0.10
Net asset value per share, end of period	\$ 4.51	\$ 4.30	\$ 4.51	\$ 4.30
Stock price per share, end of period	\$ 4.27	\$ 6.25	\$ 4.27	\$ 6.25
Total return based on stock price (2)	4.40%	7.20%	(6.56)%	58.23%
<b>Supplemental Data:</b>				
Net assets, end of period	\$ 139,280,510	\$ 111,532,206	\$ 139,280,510	\$ 111,532,206
Ratio of expenses to average net assets (2)	1.4%	2.1%	4.5%	5.9%
Ratio of net operating loss to average net assets (2)	(1.3)%	(2.0)%	(4.3)%	(5.8)%
Number of shares outstanding, end of period	30,870,205	25,966,758	30,870,205	25,966,758

\*Based on Average Shares Outstanding

(1) Net realized and unrealized gains (losses) include rounding adjustments to reconcile change in net asset value per share. See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a description of realized and unrealized gains and losses.

(2) Not annualized

The accompanying notes are an integral part of this schedule.



Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information contained in this section should be read in conjunction with the Company's unaudited September 30, 2010, Consolidated Financial Statements and the Company's audited 2009 Consolidated Financial Statements and notes thereto.

Background and Overview

We incorporated under the laws of the state of New York in August 1981. In 1983, we completed an initial public offering ("IPO"). In 1984, we divested all of our assets except Otisville BioTech, Inc., and became a financial services company with the investment in Otisville as the initial focus of our business activity.

In 1992, we registered as an investment company under the 1940 Act, commencing operations as a closed-end, non-diversified investment company. In 1995, we elected to become a BDC subject to the provisions of Sections 55 through 65 of the 1940 Act.

We are a venture capital company that specializes in making investments in companies commercializing and integrating products enabled by nanotechnology and microsystems. We define venture capital investments as the money and resources made available to privately held start-up firms and privately held and publicly traded small businesses with exceptional growth potential. Nanotechnology is the study of structures measured in nanometers, which are units of measurement in billionths of a meter. Microsystems are measured in micrometers, which are units of measurement in millionths of a meter. We sometimes use "tiny technology" to describe both of these disciplines.

We consider a company to fit our investment thesis if the company employs or intends to employ technology that we consider to be at the microscale or smaller and if the employment of that technology is material to its business plan. By making these investments, we seek to provide our shareholders with a specific focus on nanotechnology and microsystems through a portfolio of venture capital investments that address a variety of markets and products.

As of September 30, 2010, \$96,779,429, or 68 percent, of our total assets at fair value consisted of privately held venture capital investments, net of unrealized depreciation of \$1,607,893. As of December 31, 2009, \$77,797,086, or 57 percent, of our total assets at fair value consisted of privately held venture capital investments, net of unrealized depreciation of \$14,293,994.

We believe that we are the only publicly traded BDC making venture capital investments exclusively in nanotechnology and microsystems. We believe we provide four core benefits to our shareholders. First, we are an established firm with a track record of investing in venture capital-backed companies. Second, we provide shareholders with access to emerging companies that commercialize and integrate products enabled by nanotechnology and microsystems that are privately and publicly owned. Third, we have an existing portfolio of companies that we believe are comparable in stage to those found in the latter years of a private venture capital fund. Fourth, we provide access to venture capital investments in a vehicle that, unlike private venture capital firms, is both transparent and liquid.

## Investment Strategy

We have discretion in the investment of our capital. Throughout our corporate history, we have made primarily early-stage venture capital investments in a variety of industries. These businesses can range in stage from pre-revenue to generating positive cash flow. These businesses tend to be thinly capitalized, unproven, small companies that lack management depth, have little or no history of operations and are developing unproven technologies. We historically have invested in equity securities of these companies that take the form of preferred stock and that are generally illiquid due to restrictions on resale and to the lack of an established trading market.

Additionally, we provide debt financing to privately held or publicly traded companies that are generating cash or have near-term visibility to reaching positive cash flow. Credit remains extremely expensive or unavailable for even the strongest small privately held and publicly traded companies. In addition to fees and monthly principal and interest payments, we may receive warrants in these investments. Providing venture debt enables us to generate near-term cash flow with a defined period for return on our investment.

With the lengthening time between investment and return on investment in privately held venture capital-backed companies, we seek to generate returns with greater frequency by also investing in publicly traded companies. Some of these companies have revenue and some are generating positive cash flow. Several of these companies are one to two years ahead of similar venture capital-funded, privately held companies but currently trade at a deep discount to the value of similar privately held companies. We believe our time frame from investment to monetization of our investment in these publicly traded companies could be shorter than that of our privately held companies and that our domain expertise, combined with our venture capital skill-sets and deal structure know-how, provide important competitive advantages in this space. Although currently we are focused primarily on investing in opportunities with market capitalizations below \$50 million, we may invest in publicly traded companies with market capitalizations anywhere below \$500 million.

## Historical Investments

Since our investment in Otisville in 1983 through September 30, 2010, we have made a total of 89 venture capital investments. We have exited 58 of these 89 investments, realizing total gross proceeds of \$144,325,044 on our cumulative invested capital of \$75,537,972.

In 1994, we invested in our first nanotechnology company, Nanophase Technologies Corporation. Recognizing the potential of nanotechnology, we continued to monitor developments in the field. From August 2001 through September 30, 2010, all 47 of our initial investments have been in companies commercializing or integrating products enabled by nanotechnology or microsystems. From August 2001 through September 30, 2010, we have invested a total (before any subsequent write-ups, write-downs or dispositions) of \$126,415,833 in these companies. We currently have 31 companies in our portfolio, including one investment made prior to 2001. At September 30, 2010, from first dollar in, the average and median holding periods for these 31 investments were 4.9 years and 4.5 years, respectively. Historically, as measured from first dollar in to last dollar out, the average and median holding periods for the 58 investments we have exited were 3.9 years and 3.3 years, respectively.

## Investment Pace

The following is a summary of our initial and follow-on investments in nanotechnology from January 1, 2006, to September 30, 2010. We consider a "round led" to be a round where we were the new investor or the leader of a set of investors in an investee company. Typically, but not always, the lead investor negotiates the price and terms of the deal with the investee company.

	2006	2007	2008	2009	Nine Months Ended September 30, 2010
Total Incremental Investments	\$24,408,187	\$20,595,161	\$17,779,462	\$12,334,051	\$9,667,071

## Investments in Equity and Convertible Bridge Notes in Privately Held Companies

No. of New Investments	6	7	4	1	1
No. of Follow-On Investment Rounds	14	20	25	27	22
No. of Rounds Led	7	3	4	5	4
Average Dollar Amount – Initial	\$2,383,424	\$1,086,441	\$683,625	\$250,000	\$250,000
Average Dollar Amount – Follow-On	\$721,974	\$649,504	\$601,799	\$436,490	\$394,027

## Investments in Equity in Publicly Traded Companies

No. of New Investments(1)	0	0	0	1	1
No. of Follow-On Investment Rounds(1)	0	0	0	2	3
Average Dollar Amount – Initial	\$0	\$0	\$0	\$99,624	\$99,957
Average Dollar Amount – Follow-On	\$0	\$0	\$0	\$99,602	\$49,507

## Investments in Non-Convertible Debt Securities

No. of New Investments	0	0	0	0	1
Average Dollar Amount	\$0	\$0	\$0	\$0	\$500,000

(1) These investments in publicly traded companies were subsequently sold. At September 30, 2010, we had no equity investments in publicly traded companies.

#### Importance of Availability of Liquid Capital

Private venture capital funds are structured commonly as limited partnerships with a committed level of capital and finite lifetime. Capital is "called" from limited partners to make investments and pay for expenses of running the firm at various points within the lifetime of the fund. For each initial investment, the fund must reserve additional capital for follow-on investments at later stages of the life of the portfolio companies. These follow-on investments are required because often venture-backed portfolio companies in areas in which we invest, whether privately held or publicly traded, operate with negative cash flow for lengthy periods of time. In general, the cumulative total of initial invested capital and reserves cannot exceed the committed level of capital of the fund.

Our strategy for investing capital is similar to this approach in some respects. We make initial investments in privately held and publicly traded companies and project the amount of capital that may be required should the company mature successfully. These projections, equivalent to the reserves of private venture capital funds, are reviewed weekly by management, are updated frequently and are a component of the data that guide our decisions on whether to make new and follow-on investments. As a publicly traded, internally managed venture capital company, our cash used to make investments and pay expenses is held by us and not called from external sources when needed. Accordingly, it is crucial that we operate the company with a substantial balance of liquid capital for this reason and for four additional reasons.

- 1) We manage the company and our investment pace and criteria such that our projected needs for capital to make new and follow-on investments do not exceed the total of our liquid investments. Although we use best efforts to predict when this capital will be required for use in new and follow-on investments, we cannot predict with certainty the timing for these investments. We would be unable to make new or follow-on investments in our portfolio companies without having substantial liquid resources of capital available to us.
- 2) Venture capital firms traditionally invest beside other venture capital firms in a process called syndication. The size of the fund and the amount of capital reserves available to syndicate partners is often an attribute that potential co-investors consider when deciding on syndicate partners. As we do not have committed capital from limited partners, we believe we must have adequate available liquid capital on our balance sheet to be able to have access to high-quality deal flow.
- 3) We rarely commit the total amount of cumulative capital intended for investment in any portfolio company at one point in time. Instead, our investments consist of multiple rounds of financing of a given portfolio company, in which we typically participate if we believe that the merits of such an investment outweigh the risks. We also commonly have preemptive rights to invest additional capital in our privately held portfolio companies. These rights are useful to protect and potentially increase the value of our positions in our portfolio companies as they mature. Commonly, the terms of such financings in privately held companies also include penalties for those investors that do not invest in these subsequent rounds of financing. Without available capital at the time of investment, our ownership in the company would be subject to these penalties that can lead to a partial or complete loss of the capital invested prior to that round of financing.
- 4) We may have the opportunity to increase ownership in late rounds of financing in some of our most mature companies. Many private venture capital funds that invested in these companies are reaching the end of the term associated with their limited partnerships. This issue may limit the available capital to these funds for follow-on investments, and the ability to take advantage of potentially valuable terms given to those who have investable capital. Having permanent, liquid capital available for investment allows us to take advantage of these opportunities as they arise.

### Involvement with Portfolio Companies

The 1940 Act requires that BDCs offer to "make available significant managerial assistance" to portfolio companies. We are actively involved with our portfolio companies through membership on boards of directors, as observers to the boards of directors and/or through frequent communication with management. As of September 30, 2010, we held at least a board seat or observer rights on 25 of our 31 portfolio companies (81 percent).

We may hold two or more board seats in early-stage portfolio companies or those in which we have significant ownership. As of September 30, 2010, we held two board seats in Ancora Pharmaceuticals and Enumeral Technologies. We may transition off of the board of directors to an observer role as our portfolio companies raise additional capital from new investors, as they mature or as they are able to attract independent members who have relevant industry experience and contacts. We also typically step off the board of directors upon the completion of an IPO.

We may be actively involved in the formation and development of business strategies of our earliest stage portfolio companies. This involvement may include hiring management, licensing intellectual property, securing space and raising additional capital. We also provide managerial assistance to late-stage companies looking for potential exit opportunities by leveraging our status as a publicly traded company through our relationships with the banking community and our knowledge and experience implementing and complying with Section 404 of the Sarbanes-Oxley Act for larger companies.

### Commercialization of Nanotechnology by Our Portfolio Companies

Our nanotechnology investments have matured around three main industry clusters: cleantech (45.1 percent of our venture capital portfolio as of September 30, 2010); electronics, including semiconductors (25.6 percent of our venture capital portfolio as of September 30, 2010); and healthcare/biotechnology (14.2 percent of our venture capital portfolio as of September 30, 2010). We call these three areas "Nanotech for Cleantech<sup>SM</sup>," "Nanotech for Electronics<sup>SM</sup>," and "Nanotech for Healthcare<sup>SM</sup>," respectively. We have and may continue to make investments outside these industry areas, and we may not maintain these industry clusters or the weightings within these clusters.

These three clusters are comprised of multi-billion dollar industries that have grown historically through innovation of technology. "Cleantech" is a term used commonly to describe products and processes that solve global problems related to resource constraints. We classify Nanotech for Cleantech<sup>SM</sup> 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 Nanotech for Electronics<sup>SM</sup> companies as those that use nanotechnology to address problems in electronics-related industries, including semiconductors.

We classify Nanotech for Healthcare<sup>SM</sup> companies as those that use nanotechnology to address problems in healthcare-related industries, including biotechnology, pharmaceuticals and medical devices.

We believe the development and commercialization of nanotechnology-enabled solutions are the result of the convergence of traditionally separate scientific disciplines such as biology, materials science, chemistry, electronics, information technology, and physics. We believe such nanotechnology enabled advances in each of these industry clusters, and in general, could not otherwise occur within one discipline alone.

We define market domains as groupings of technology that enable new user, business or economic experiences. There are many billion-dollar market domains within each of the above listed industry clusters. These market domains hold the potential for effecting substantial change in everyday life. Our experience is that technology adoption occurs on two time scales. Existing market domains can allow for rapid adoption as new technologies are continuously added to the existing domain. These new technologies refine and improve the existing experience provided by the market domain. Emerging market domains often require more time for the adoption of technology than existing market domains, as the new market domain is itself being absorbed by society and the economy.

We classify our portfolio companies into either existing market domains or emerging market domains. We expect that the time scale at which these companies mature commercially will be impacted by whether their technology is being adopted into an existing market domain or an emerging market domain. We continue to look for investment opportunities in emerging market domains, as we believe these investments have the potential to create outsized venture capital returns.



### Maturity of Current Venture Capital Portfolio

Our venture capital portfolio is composed of companies at varying maturities facing different types of risks. We have defined these levels of maturity and sources of risk as: 1) Early Stage / Technology Risk, 2) Mid Stage / Market Risk and 3) Late Stage / Execution Risk. Early-stage companies have a high degree of technical, market and execution risk, which is typical of initial investments by venture capital firms, including us. These companies often require substantial development of their technologies before they begin introducing products to market. Mid-stage companies are those that have overcome most of the technical risk associated with their products and are now focused on addressing the market acceptance for their products. For those companies developing therapeutics or medical devices, the focus is on bringing their products through the first phases of clinical trials. Late-stage companies are those that have determined there is a market for their products, and they are now focused on sales execution and scale. Late-stage healthcare and biotechnology companies are typically either in Phase III Clinical Trials, which are the pivotal trials before a possible FDA approval and commercial launch of a product, or are generating revenue from the commercial sale of one or more products. The charts below show our assessment of the stage of maturity of our 31 portfolio companies and the distribution of ownership of our portfolio companies within each of these stages of maturity, respectively.



We seek to create a portfolio of companies that enables consistent flows of potential exit events in multiple industry sectors that can be monetized as these companies mature. We believe a portfolio of companies focused on a diverse set of industry clusters reduces the potential impact of cyclicity of any one cluster on the flow of potential exit events. Our current portfolio is comprised of companies at varying stages of maturity in a diverse set of industry clusters. As our portfolio companies mature, we seek to invest in new early and mid-stage companies that may mature into mid and late-stage companies. This continuous progression creates a pipeline of investment maturities that may lead to more frequent exit events of our portfolio companies. This pipeline is demonstrated by the distribution of our current portfolio companies by stage within each industry cluster.

We expect some of our portfolio companies to transition between stages of maturity over time. This transition may be forward if the company is maturing and is successfully executing its business plan or may be backward if the company is not successfully executing its business plan or decides to change its business plan substantially from its original plan. Transitions backward are commonly accompanied by an increase in non-performance risk, which reduces valuation. We discuss non-performance risk and its implications on value below in the section titled Valuation of Investments.

From June 30, 2010, to September 30, 2010, we transitioned one company, Nanosys, Inc., from being classified as a mid-stage company to a late-stage company. We classified our new portfolio company, GEO Semiconductor Inc., as a mid-stage company as of September 30, 2010.

We currently have 22 companies in our venture capital portfolio that generate revenues ranging from nominal to significant from commercial sales of products and/or services, from commercial partnerships and/or from government grants.

On April 15, 2010, NeoPhotonics Corporation filed a registration statement on Form S-1 to register its shares of common stock for an IPO. We believe that in the next 6 to 12 months one or more of our other late-stage portfolio companies could take steps toward a filing of a registration statement on Form S-1 for an IPO. There can be no assurance that these companies will successfully complete IPOs, and a variety of factors, including stock market and general business conditions, could lead them to terminate such IPOs.

During the third quarter of 2010, two of our privately held companies retained bankers to explore opportunities to sell those companies. There can be no assurance that these companies will successfully complete a sale. A variety of factors, including general business conditions, could lead them to terminate such efforts.

#### Current Business Environment

The third quarter of 2010 concluded with the public markets increasing broadly in value, including the best performance in the month of September since 1939. Amidst this improvement in the value of public equities, there were continued positive signs in the exit market for venture-backed companies with nine venture-backed companies managing to complete IPOs, up from two IPOs in the same quarter of 2009. However, most companies that debuted on a public exchange either priced lower than expected, performed poorly once they debuted, or both. The number of merger and acquisition ("M&A") transactions of venture-backed companies was up from the second quarter of 2010; however, the median amount paid for a venture-backed company in the most recent quarter was \$27 million, almost three times less than the median sale price during the second quarter of 2010. According to Dow Jones VentureSource, it took a median of 4.8 years and a median of \$23 million for a venture-backed company to reach liquidity through M&A transactions in the third quarter of 2010. This is 20 percent less time and 30 percent more capital than the same period last year. Venture-backed companies that went public in the most recent quarter took a median of 6.7 years to achieve liquidity, 16 percent less time than the median in the third quarter of 2009. The \$51 million median amount of venture capital raised prior to liquidity (IPO or M&A) during the most recent quarter is 21 percent higher than the median in the third quarter of 2009. We expect that it may take significantly more time for the exit market for venture-backed companies to recover from the current economic turmoil than the public stock markets. Additionally, any increase in volatility in the financial markets may impact opportunities for IPOs.

The venture capital industry's 10-year performance stands at minus 4.2 percent as of June 30, 2010, a reversal from positive 35 percent as of December 31, 2008, according to Cambridge Associates LLC and the National Venture Capital Association. U.S. venture firms raised \$9.2 billion for 103 funds during the first three quarters, according to Dow Jones LP Source. This amount is slightly more than the \$8.9 billion raised for 105 funds during the same period in 2009. Capital raised by early-stage funds fell 12 percent to \$3.4 billion for 65 funds, while investment in later-stage funds, traditionally the smallest sector for fundraising, rose 71 percent as five funds raised \$1.3 billion. Venture fundraising for all of last year totaled \$13.5 billion, the lowest since 2003. These amounts of investment remain below those prior to the onset of the financial crisis in the third quarter of 2008. We believe these data support our conclusion that the availability of capital for venture capital firms and venture-backed companies continues to be restricted.

Many of our portfolio companies have negative cash flow and, therefore, need additional rounds of financing to continue operations. Historically, this capital typically comes from the existing venture capital syndicate as well as new investors. As a result of the economic downturn and the tight availability of capital for investment by venture capital firms, the existing investors in a syndicate are increasingly required to provide this capital without the participation of new investors. This limited market for capital to invest also affects existing members of syndicates of investors. Some of these co-investors are unable to invest their full pro rata amount of a round of financing, if at all, which results in a fractured syndicate. A fractured syndicate can result in a portfolio company being unable to raise additional capital to fund operations. The portfolio company may be forced to sell before reaching its full potential or be shut down entirely if the remaining investors cannot financially support the company.

Our overall goal remains unchanged, which is to maintain our leadership position in investing in nanotechnology and microsystems and to increase our NAV. The current environment for venture capital financings favors those firms that have capital to invest regardless of the stage of the investee company. We have not used leverage or debt financing when making equity and convertible debt investments; thus, we continue to finance our new and follow-on equity and convertible debt investments from our cash reserves, currently invested in U.S. treasury obligations. We believe the turmoil of the venture capital industry and the current economic climate provide opportunities to invest this capital at historically low valuations in new and existing privately held and publicly traded companies of varying maturities.

#### Valuation of Investments

We value our privately held venture capital investments each quarter as determined in good faith by our Valuation Committee, a committee of all the independent directors, within guidelines established by our Board of Directors in accordance with the 1940 Act. (See "Footnote to Consolidated Schedule of Investments" contained in "Consolidated Financial Statements.")

The values of privately held, venture capital-backed companies are inherently more difficult than publicly traded companies to assess at any single point in time because securities of these types of companies are not actively traded. We believe, perhaps even more than in the past, that illiquidity, and the perception of illiquidity, can affect value.

Difficult economic environments can result in weak companies not receiving financing and being subsequently closed down with a loss to venture investors, and/or strong companies receiving financing but at significantly lower valuations than the preceding financing rounds. The current state of the venture capital market limits the availability of capital for investment by venture capital firms. Increasingly, existing investors in a syndicate are required to provide capital without the participation of new investors. Some of these existing investors are unable to invest their full pro rata amount of a private round of financing, if at all, which results in a fractured syndicate. A fractured syndicate can result in a privately held portfolio company being unable to raise additional capital to fund operations regardless of the potential of the intellectual property or the business of the portfolio company. The portfolio company may be forced to sell before reaching its full potential or be shut down entirely if the remaining investors cannot financially support the company. These scenarios may adversely affect value.

In each of the years in the period 2006 through 2009, and for the nine months ended September 30, 2010, the Company recorded the following gross write-ups in privately held securities as a percentage of net assets at the beginning of the year ("BOY"), gross write-downs in privately held securities as a percentage of net assets at the beginning of the year, and change in value of privately held portfolio securities as a percentage of net assets at the beginning of the year.

	2006	2007	2008	2009	Nine Months Ended September 30, 2010
Net Asset Value, BOY	\$117,987,742	\$113,930,303	\$138,363,344	\$109,531,113	\$134,158,258
Gross Write-Downs During Year	\$(4,211,323)	\$(7,810,794)	\$(39,671,588)	\$(12,845,574)	\$(8,996,223)
Gross Write-Ups During Year	\$279,363	\$11,694,618	\$820,559	\$21,631,864	\$18,545,772
Gross Write-Downs as a Percentage of Net Asset Value, BOY	-3.57%	-6.86%	-28.67%	-11.7%	-6.7%
Gross Write-Ups as a Percentage of Net Asset Value, BOY	0.24%	10.26%	0.59%	19.7%	13.8%
Net Change as a Percentage of Net Asset Value, BOY	-3.33%	3.40%	-28.08%	8.0%	7.1%

From December 31, 2009, to September 30, 2010, the value of our privately held venture capital portfolio increased by \$18,982,343 from \$77,797,086 to \$96,779,429. The table below indicates some of the inputs used to determine value of our privately held portfolio companies and the portion of the change in value, on a quarter over quarter basis, relevant to those inputs. We note that our Valuation Committee takes into account multiple quantitative and qualitative inputs to ultimately determine the value of our privately held portfolio companies.

	Q2 2010 to Q3 2010	Q1 2010 to Q2 2010	Q4 2009 to Q1 2010	Q3 2009 to Q4 2009
Value of Privately Held Portfolio as of Previous Quarter	\$92,039,997	\$83,014,946	\$77,797,086	\$69,876,210
Value of Privately Held Portfolio as of Current Quarter	\$96,779,429	\$92,039,997	\$83,014,946	\$77,797,086

## Examples of Inputs that Contribute to Changes in Value

Total New and Follow-On Investments	\$3,320,255	\$4,652,106	\$1,426,580	\$4,698,782
(+) Due to Terms of New Equity Rounds of Financing	\$1,023,808	\$11,564,433	\$1,436,628	\$5,229,990
(-) Due to Terms of New Equity Rounds of Financing	\$0	\$(280,649)	\$0	\$0
(+) Due to (+) in Values of Comparables	\$1,407,773	\$730,026	\$2,151,404	\$1,938,047
(-) Due to (-) in Values of Comparables	\$0	\$(1,618,341)	\$0	\$(6,313)
(+) Due to (-) in Non-Performance Risk	\$53,893	\$1,355,025	\$2,511,106	\$500,000
(-) Due to (+) in Non-Performance Risk	\$(1,304,165)	\$(7,172,178)	\$(2,307,768)	\$(4,795,765)
Other Factors(1)	\$237,868	\$(205,371)	\$(90)	\$356,135
Total Change in Value of Privately Held Portfolio from Quarter to Quarter	\$4,739,432	\$9,025,051	\$5,217,860	\$7,920,876

(1) Other factors include changes in accrued bridge note interest, currency fluctuations and the value of warrants.

The values of publicly traded comparables on September 30, 2010, were significant factors in determining the values of four of our 31 privately held portfolio companies. One of these four companies is GEO Semiconductor Inc. Our investment of \$500,000 in GEO Semiconductor occurred through a participation agreement with Montage Capital, LLC, for pro rata ownership of a senior secured non-convertible debt security that included warrants for the purchase of preferred stock at a future date. As part of this investment, we also received payment of a loan initiation fee. Should we decide to sell this note and the warrants, the purchaser would not receive the loan initiation fee. The difference between the amount invested in GEO Semiconductor and the value of our investment as of September 30, 2010, results primarily from the effect of this loan initiation fee on the calculation value by a discounted cash flow analysis. With the information available to us as of September 30, 2010, we believe the investment will return its full amount of interest and principal under the terms of the investment.





The other three companies for which publicly traded comparables were significant factors in determining value increased in value for the three months ended September 30, 2010. These four companies accounted for approximately \$15.1 million of the total value of our venture capital portfolio as of September 30, 2010. These values could differ materially if calculated on a different date due to changes in values and/or operating performance of the publicly traded comparables.

The values set by private equity financings that occurred during the third quarter of 2010, or that occurred during the fourth quarter of 2010, but reflect on value as of September 30, 2010, were significant inputs in determining the values of four of our 31 privately held portfolio companies. These four companies accounted for approximately \$29.1 million of the total value of our venture capital portfolio as of September 30, 2010. The financings of three of these four portfolio companies included third-party independent investors and accounted for \$28.9 million of the \$29.1 million. The financings of one of these four portfolio companies included only current investors and accounted for \$0.2 million of the \$29.1 million. These values could differ materially in future quarters, particularly should these companies not execute on their business plans and become subject to discounts for non-performance risk or require additional capital that is available only at lower valuations than those of the most recent round of financing.

As part of the valuation process, we consider non-performance risk. Non-performance risk is the risk that a portfolio company will be: (a) unable to raise capital, will need to be shut down and will not return our invested capital; or (b) able to raise capital, but at a valuation significantly lower than the implied post-money valuation. Our best estimate of the non-performance risk of our portfolio companies has been quantified and included in the valuation of the companies as of September 30, 2010. In the future, as these companies receive terms for additional financings or are unable to receive additional financing and, therefore, proceed with sales or shutdowns of the business, we expect the contribution of the discount for non-performance risk to vary in importance in determining the values of our securities of these companies. As of September 30, 2010, non-performance risk was a significant factor in determining the values of 11 of our 31 privately held portfolio companies. These 11 companies accounted for approximately \$23.9 million of the total value of our privately held venture capital portfolio. We increased the non-performance risk, thereby decreasing the value, of two companies. We decreased the non-performance risk, thereby increasing the value, of one company. We maintained the same level of non-performance risk in eight companies.

As of September 30, 2010, our top ten investments by value accounted for approximately 71 percent of the value of our venture capital portfolio. As of that date, we believe at least one of these ten companies will require capital by the end of 2010, and at least three of the remaining nine companies will require additional capital by the end of the third quarter of 2011.

The increase or decrease in the value of our venture capital investments does not affect the day-to-day operations of the Company, as we have no debt and fund our venture capital investments and daily operating expenses from interest earned and proceeds from the sales of our investments in U.S. government and agency obligations. As of September 30, 2010, we held \$43,860,344 in U.S. government obligations, and we had an additional \$256,103 in cash.

#### Investment Objective

Our principal objective is to achieve long-term capital appreciation by making venture capital investments. Therefore, a significant portion of our current venture capital investment portfolio provides little or no income in the form of dividends or interest. Current income is a secondary objective. We are implementing a strategy that we believe will provide greater regularity and shorter time periods between realizations of capital gains on investments. As part of this strategy, we are seeking to increase our current income by providing debt financing to privately held and publicly traded small companies. We made our first debt investment that generates current income in the third quarter of 2010. We seek to reach the point where future growth is financed through reinvestment of our capital gains from our venture capital investments and where current income offsets our annual expenses during periods of time between realizations of capital gains on our investments.

We currently earn interest income from fixed-income securities, including U.S. government and agency securities. The amount of interest income we earn varies with the average balance of our fixed-income portfolio and the average yield on this portfolio. In previous years, we have been able to generate substantial amounts of interest income from our holdings of U.S. treasury securities. As of September 30, 2010, we held two short-duration U.S. treasury securities, yielding approximately 0.09 percent. As of September 30, 2010, yields for 3-month, 6-month, and 12-month U.S. treasury securities were 0.16 percent, 0.19 percent and 0.27 percent, respectively. With yields at this level, we expect to generate less interest income from U.S. government securities than in fiscal quarters and years prior to 2009.

## Results of Operations

We present the financial results of our operations utilizing GAAP for investment companies. On this basis, the principal measure of our financial performance during any period is the net increase (decrease) in our net assets resulting from our operating activities, which is the sum of the following three elements:

**Net Operating Income (Loss)** - the difference between our income from interest, dividends, and fees and our operating expenses.

**Net Realized Gain (Loss) on Investments** - the difference between the net proceeds of sales of portfolio securities and their stated cost, plus income from interests in limited liability companies.

**Net Increase (Decrease) in Unrealized Appreciation or Depreciation on Investments** - the net unrealized change in the value of our investment portfolio.

Owing to the structure and objectives of our business, we generally expect to experience net operating losses and seek to generate increases in our net assets from operations through the long term appreciation of our venture capital investments. Historically, we have relied on proceeds from sales of investments, rather than on investment income, to defray a significant portion of our operating expenses. Because such sales are unpredictable, we attempt to maintain adequate working capital to provide for fiscal periods when there are no such sales. We began efforts to generate additional current income in the third quarter of 2010 by making a venture debt investment. Although we plan to continue to make investments in securities that produce current income, we do not believe these investments will reach an amount that would generate enough income to offset a significant portion of our operating expenses within the next 12 months.

Three months ended September 30, 2010, as compared with the three months ended September 30, 2009

In the three months ended September 30, 2010, and September 30, 2009, we had net decreases in net assets resulting from operations of \$454,032 and \$296,319, respectively.

## Investment Income and Expenses:

We had net operating losses of \$1,768,864 and \$2,242,953 for the three months ended September 30, 2010, and September 30, 2009, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expense of \$531,795 in 2010 and \$1,013,608 in 2009 associated with the granting of stock options. During the three months ended September 30, 2010, and 2009, total investment income was \$140,445 and \$105,677, respectively. During the three months ended September 30, 2010, and 2009, total operating expenses were \$1,909,309 and \$2,348,630, respectively.

During the three months ended September 30, 2010, as compared with the same period in 2009, investment income increased, reflecting an increase in interest income from bridge notes and the participation agreement, offset by a decrease in our average holdings of U.S. government securities as well as a decrease in the average interest rates yielded by these securities. The average yield on our U.S. government securities decreased from 0.3 percent for the three months ended September 30, 2009, to 0.1 percent for the three months ended September 30, 2010. During the three months ended September 30, 2010, our average holdings of such securities were \$44,971,268, as compared with \$49,590,199 during the three months ended September 30, 2009.

Operating expenses, including non-cash, stock-based compensation expense, were \$1,909,309 and \$2,348,630 for the three months ended September 30, 2010, and September 30, 2009, respectively. The decrease in operating expenses for the three months ended September 30, 2010, as compared with the three months ended September 30, 2009, was primarily owing to decreases in salaries, benefits and stock-based compensation expense, administration and operations expense, professional fees, directors' fees and expenses and custody fees, offset by an increase in rent expense. Salaries, benefits and stock-based compensation decreased by \$400,688, or 23.2 percent, through September 30, 2010, as compared with September 30, 2009, primarily as a result of a decrease in non-cash expense of \$481,813 associated with the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan"), offset by an increase in salaries and benefits owing primarily to an accrual for year-end employee bonuses of \$59,750 and to an increase in salary of two of our employees. While the non-cash, stock-based compensation expense for the Stock Plan increased our operating expenses by \$531,795, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our NAV. Administration and operations expense decreased by \$23,822, or 10.6 percent, through September 30, 2010, as compared with September 30, 2009, primarily as a result of a decrease in our directors' and officers' liability insurance expense and decreases in the expenses related to the annual report and proxy. Professional fees decreased by \$54,299, or 28.4 percent, for the three months ended September 30, 2010, as compared with the same period in 2009, primarily as a result of a decrease in certain legal and accounting fees, offset by an increase in consulting fees. Directors' fees and expenses decreased by \$8,777, or 11.1 percent, through September 30, 2010, as compared with September 30, 2009, primarily as a result of one less meeting held during the quarter. Custody fees decreased by \$9,515, or 28.4 percent, for the three months ended September 30, 2010, as compared with the same period in 2009, owing to a higher accrual in the third quarter of 2009 for services provided by our new custodian, from the inception of the agreement in May 2009 to September 2009. Rent expense increased by \$57,262, or 71.9 percent, for the three months ended September 30, 2010, as compared with the same period in 2009. Our rent expense of \$136,879 for the three months ended September 30, 2010, includes \$141,674 of rent paid in cash and \$(4,795) of non-cash rent expense, credits and abatements that we recognize on a straight-line basis over the lease term. Our rent paid in cash of \$141,674 includes \$47,094 of real estate tax escalation charges from 2003 to 2010 paid on our previous corporate headquarters located at 111 West 57 Street in New York City.

## Realized Income and Losses from Investments:

During the three months ended September 30, 2010, and September 30, 2009, we realized net losses on investments of \$3,136,863 and \$3,176,125, respectively.

During the three months ended September 30, 2010, we realized net losses of \$3,136,863, consisting primarily of a realized loss on our investment in NanoGram Corporation, of \$3,136,552. On July 11, 2010, NanoGram was acquired for an undisclosed amount. Holders of common stock did not receive any proceeds from this transaction.

During the three months ended September 30, 2009, we realized net losses of \$3,176,125, consisting of a realized loss of \$3,176,125 on our investment in Nanomix, Inc. During the third quarter of 2009, we received a payment of \$4,115 for the sale of our interest in Nanomix, Inc.

## Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the three months ended September 30, 2010, net unrealized depreciation on total investments decreased by \$4,453,494, or 73.5 percent, from net unrealized depreciation of \$6,062,635 at June 30, 2010, to net unrealized depreciation of \$1,609,141 at September 30, 2010. During the three months ended September 30, 2009, net unrealized depreciation on total investments decreased by \$5,119,897, or 17.6 percent, from net unrealized depreciation of \$29,013,339 at June 30, 2009, to net unrealized depreciation of \$23,893,442 at September 30, 2009.

During the three months ended September 30, 2010, net unrealized depreciation on our venture capital investments decreased by \$4,436,960, from net unrealized depreciation of \$6,044,853 at June 30, 2010, to net unrealized depreciation of \$1,607,893 at September 30, 2010, owing primarily to increases in the valuations of the following investments held:

Investment	Amount of Write-Up
Bridgelux, Inc.	\$ 10,594
D-Wave Systems, Inc.	73,713
GEO Semiconductor Inc.	10,052
Laser Light Engines, Inc.	1,023,808
NeoPhotonics Corporation	980,947
PolyRemedy, Inc.	53,893
Questech Corporation	106,840
Xradia, Inc.	312,110

The write-ups for the three months ended September 30, 2010, were partially offset by decreases in the valuations of the following investments held:

Investment	Amount of Write-Down
BioVex Group, Inc.	\$ 3,134
Innovalight, Inc.	1,241,665
Mersana Therapeutics, Inc.	23,822
Metabolon, Inc.	6,678
Molecular Imprints, Inc.	8,125
SiOnyx, Inc.	1,731
TetraVitae Bioscience, Inc.	62,500

We had a decrease in unrealized depreciation for NanoGram Corporation of \$3,136,552. On July 11, 2010, NanoGram Corporation was acquired for an undisclosed amount. Holders of common stock did not receive any proceeds from this transaction.

We had a decrease in unrealized depreciation owing to foreign currency translation of \$76,106 on our investment in D-Wave Systems, Inc.

Unrealized depreciation on our U.S. government securities portfolio decreased from \$17,782 at June 30, 2010, to \$1,248 at September 30, 2010.

During the three months ended September 30, 2009, net unrealized depreciation on our venture capital investments decreased by \$5,125,667, from net unrealized depreciation of \$29,029,756 at June 30, 2009, to net unrealized depreciation of \$23,904,089 at September 30, 2009, owing primarily to increases in the valuations of the following investments held:

Investment	Amount of Write-Up
Adesto Technologies Corporation	\$ 1,320,000
BioVex Group, Inc.	350,867
BridgeLux, Inc.	997,091
Cambrios Technologies Corporation	519,567
CFX Battery, Inc.	812,383
NeoPhotonics Corporation	1,521,999
Questech Corporation	189,860
Xradia, Inc.	1,118,602

The write-ups for the three months ended September 30, 2009, were partially offset by decreases in the valuations of the following investments held:

Investment	Amount of Write-Down
Ancora Pharmaceuticals Inc.	\$ 405,969
Cobalt Technologies, Inc.	187,499
Crystal IS, Inc.	440,543
Innovalight, Inc.	1,561,187
Kovio, Inc.	1,232,466
Laser Light Engines, Inc.	499,999
Mersana Therapeutics, Inc.	4,581
Metabolon, Inc.	4,963
Molecular Imprints, Inc.	7,000
NanoGram Corporation	735,902
Orthovita, Inc.	26,027

We also had a decrease to unrealized depreciation for Nanomix, Inc., of \$3,180,240 owing to the sale of our investment in Nanomix, Inc. We had an increase owing to foreign currency translation of \$221,194 on our investment in D-Wave Systems, Inc.

Unrealized appreciation on our U.S. government securities portfolio decreased from \$16,417 at June 30, 2009, to \$10,647 at September 30, 2009.

Nine months ended September 30, 2010, as compared with the nine months ended September 30, 2009

In the nine months ended September 30, 2010, we had a net increase in net assets resulting from operations of \$3,384,651. In the nine months ended September 30, 2009, we had a net decrease in net assets resulting from operations of \$826,376.

#### Investment Income and Expenses:

We had net operating losses of \$5,835,491 and \$6,340,103 for the nine months ended September 30, 2010, and September 30, 2009, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expense of \$1,746,734 in 2010 and \$2,425,525 in 2009 associated with the granting of stock options. During the nine months ended September 30, 2010, and 2009, total investment income was \$348,726 and \$165,950, respectively. During the nine months ended September 30, 2010, and 2009, total operating expenses were \$6,184,217 and \$6,506,053, respectively.

During the nine months ended September 30, 2010, as compared with the same period in 2009, investment income increased, reflecting an increase in interest income from bridge notes and the participation agreement, offset by a decrease in our average holdings of U.S. government securities as well as a substantial decrease in interest rates. The average yield on our U.S. government securities decreased from 0.3 percent for the nine months ended September 30, 2009, to 0.09 percent for the nine months ended September 30, 2010. During the nine months ended September 30, 2010, our average holdings of such securities were \$49,440,025, as compared with \$50,447,538 at September 30, 2009.





Operating expenses, including non-cash, stock-based compensation expense, were \$6,184,217 and \$6,506,053 for the nine months ended September 30, 2010, and September 30, 2009, respectively. The decrease in operating expenses for the nine months ended September 30, 2010, as compared with the nine months ended September 30, 2009, was primarily owing to decreases in salaries, benefits and stock-based compensation expense, administration and operations expense, professional fees, and directors' fees and expenses, offset by an increase in rent expense and custody fees. Salaries, benefits and stock-based compensation decreased by \$439,828, or 9.5 percent, through September 30, 2010, as compared with September 30, 2009, primarily as a result of a decrease in non-cash expense of \$678,791 associated with the Stock Plan, offset by an increase in salaries and benefits owing primarily to an accrual for year-end employee bonuses of \$179,250 and to an increase in salary of two of our employees. While the non-cash, stock-based compensation expense for the Stock Plan increased our operating expenses by \$1,746,734, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our NAV. Administration and operations expense decreased by \$34,650, or 4.6 percent, through September 30, 2010, as compared with September 30, 2009, primarily as a result of a decrease in our directors' and officers' liability insurance expense and decreases in the expenses related to the annual report and proxy, offset by increases in the cost of non-employee related insurance, expenses associated with the relocation of our corporate headquarters in New York City and expenses associated with hosting "Meet the Portfolio" day on May 7, 2010. Professional fees decreased by \$1,605, or 0.3 percent, for the nine months ended September 30, 2010, as compared with the same period in 2009, primarily as a result of a decrease in accounting fees, offset by an increase in certain legal and consulting fees. Directors' fees and expenses decreased by \$1,465, or 0.6 percent, through September 30, 2010, as compared with September 30, 2009, primarily as a result of less meetings held during the period. Rent expense increased by \$66,561, or 28.1 percent, for the nine months ended September 30, 2010, as compared with the same period in 2009. Our rent expense of \$303,239 for the nine months ended September 30, 2010, includes \$212,704 of rent paid in cash and \$90,535 of non-cash rent expense, credits and abatements that we recognize on a straight-line basis over the lease term. Our rent paid in cash of \$212,704 includes \$47,094 of real estate tax escalation charges from 2003 to 2010 paid on our previous corporate headquarters located at 111 West 57 Street in New York City. For the nine months ended September 30, 2010, we had a loss of \$68,038 as a result of abandoning our lease at our former office prior to the end of the lease term, which expired in April 2010. Custody fees increased by \$20,543, or 39.9 percent, for the nine months ended September 30, 2010, as compared with the same period in 2009, owing to the higher fees charged by our new custodian, the Bank of New York Mellon, which has more expertise in working with investment companies.

#### Realized Income and Losses from Investments:

During the nine months ended September 30, 2010, we realized net losses on investments of \$3,545,155, as compared with realized net losses on investments of \$4,690,780 during the nine months ended September 30, 2009.

During the nine months ended September 30, 2010, we realized net losses of \$3,545,155, consisting primarily of realized losses on a portion of our investment in Kovio, Inc., of \$257,007, in NanoGram Corporation of \$3,136,552, in Orthovita, Inc., of \$167,300, and realized losses on the disposal of fixed assets, offset by realized gains on our investment in Satcon Technology Corporation of \$14,320 and realized gains on the sale of U.S. government securities.

The realized loss on our investment in Kovio, Inc., was owing to the termination of a warrant. The warrant was terminated pursuant to the terms of the Series A' financing which closed during the second quarter of 2010.

On July 11, 2010, NanoGram was acquired for an undisclosed amount. Holders of common stock did not receive any proceeds from this transaction.

During the nine months ended September 30, 2010, we received a dividend payment of \$13,218 representing our pro rata portion of the residual net proceeds from the liquidation of Optiva, Inc. We had invested in Optiva during 2002, and in 2005, it began liquidation under an assignment for the benefit of creditors. This sum represents the final payment from the liquidation.

During the nine months ended September 30, 2009, we realized net losses of \$4,690,780, consisting primarily of realized losses on our investments in Exponential Business Development Company of \$14,330, in Kereos, Inc., of \$1,500,000, and in Nanomix, Inc., of \$3,176,125. Since the date of our investment of \$25,000 in Exponential Business Development Company in 1995, we periodically received cash distributions totaling \$31,208 through the date of the sale. During the third quarter of 2009, we received a payment of \$4,115 from the sale of our interest in Nanomix, Inc.

#### Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the nine months ended September 30, 2010, net unrealized depreciation on total investments decreased by \$12,769,728, or 88.8 percent, from net unrealized depreciation of \$14,378,869 at December 31, 2009, to net unrealized depreciation of \$1,609,141 at September 30, 2010. During the nine months ended September 30, 2009, net unrealized depreciation on total investments decreased by \$10,203,754, or 29.9 percent, from net unrealized depreciation of \$34,097,196 at December 31, 2008, to net unrealized depreciation of \$23,893,442 at September 30, 2009.

During the nine months ended September 30, 2010, net unrealized depreciation on our venture capital investments decreased by \$12,758,533, from net unrealized depreciation of \$14,366,426 at December 31, 2009, to net unrealized depreciation of \$1,607,893 at September 30, 2010, owing primarily to increases in the valuations of the following investments held:

Investment	Amount of Write-Up
BioVex Group, Inc.	\$ 418,288
D-Wave Systems, Inc.	928,738
Ensemble Therapeutics Corporation	500,000
GEO Semiconductor Inc.	10,052
Laser Light Engines, Inc.	1,523,808
Mersana Therapeutics, Inc.	937,882
Metabolon, Inc.	62,957
NeoPhotonics Corporation	975,836
Questech Corporation	44,571
SiOnyx, Inc.	3,077,034
Solazyme, Inc.	8,149,698
Xradia, Inc.	1,642,579



The write-ups for the nine months ended September 30, 2010, were partially offset by decreases in the valuations of the following investments held:

Investment	Amount of Write-Down
Bridgelux, Inc.	\$ 209,659
Innovalight, Inc.	1,241,665
Kovio, Inc.	1,750,165
Molecular Imprints, Inc.	2,031,249
Nanosys, Inc.	280,649
Nextreme Thermal Solutions, Inc.	3,303,943
PolyRemedy, Inc.	53,893
TetraVitae Bioscience, Inc.	125,000

We had a decrease in unrealized depreciation for Kovio, Inc., of \$227,469 owing to the termination of a warrant. The warrant was terminated pursuant to the terms of the Series A' financing which closed during the second quarter of 2010.

We had a decrease in unrealized depreciation for NanoGram Corporation of \$3,136,552, which resulted from a realized loss on such investment during the period. On July 11, 2010, NanoGram was acquired for an undisclosed amount. Holders of common stock did not receive any proceeds from this transaction.

We had a decrease in unrealized depreciation for Orthovita, Inc., of \$72,432 owing to the sale of its securities.

We had a decrease in unrealized depreciation owing to foreign currency translation of \$46,860 on our investment in D-Wave Systems, Inc.

Unrealized depreciation on our U.S. government securities portfolio decreased from \$12,443 at December 31, 2009, to \$1,248 at September 30, 2010.

During the nine months ended September 30, 2009, net unrealized depreciation on our venture capital investments decreased by \$10,220,759, from net unrealized depreciation of \$34,124,848 at December 31, 2008, to net unrealized depreciation of \$23,904,089 at September 30, 2009, owing primarily to increases in the valuations of the following investments held:

Investment	Amount of Write-Up
Adesto Technologies Corporation	\$ 1,320,000
BioVex Group, Inc.	331,246
BridgeLux, Inc.	995,124
Cambrios Technologies Corporation	519,567
CFX Battery, Inc.	812,383
Metabolon, Inc.	200,235
Molecular Imprints, Inc.	1,062,605
NeoPhotonics Corporation	2,094,325
Nextreme Thermal Solutions, Inc.	2,202,628

Questech Corporation	212,550
Siluria Technologies, Inc.	160,723
Solazyme, Inc.	5,376,988
Xradia, Inc.	1,118,602

These write-ups for the nine months ended September 30, 2009, were partially offset by the following write-downs:

Investment	Amount of Write-Down
Ancora Pharmaceuticals Inc.	\$ 1,165,060
Cobalt Technologies, Inc.	187,499
Crystal IS, Inc.	772,781
CSwitch Corporation	20,286
Innovalight, Inc.	1,561,187
Kovio, Inc.	1,244,957
Laser Light Engines, Inc.	999,999
Mersana Therapeutics, Inc.	12,461
NanoGram Corporation	1,471,805
Nanosys, Inc.	2,685,059
Orthovita, Inc.	26,027
PolyRemedy, Inc.	28,384
SiOnyx, Inc.	1,076,155

We also had decreases to unrealized depreciation for Exponential Business Development Company of \$15,361, Kereos, Inc., of \$1,500,000, and Nanomix, Inc., of \$3,150,190 owing to the disposal of their securities and changes in the capital account balance of Exponential Business Development Company prior to its sale.

We had an increase owing to foreign currency translation of \$399,892 on our investment in D-Wave Systems, Inc. We had an increase to unrealized depreciation on our publicly traded security, Orthovita, Inc., of \$26,027.

Unrealized appreciation on our U.S. government securities portfolio decreased from \$27,652 at December 31, 2008, to \$10,647 at September 30, 2009.

#### Financial Condition

September 30, 2010

At September 30, 2010, our total assets and net assets were \$141,630,221 and \$139,280,510, respectively. At December 31, 2009, they were \$136,109,101 and \$134,158,258, respectively.

At September 30, 2010, NAV per share was \$4.51, as compared with \$4.35 at December 31, 2009. At September 30, 2010, our shares outstanding increased to 30,870,205 from 30,859,593 at December 31, 2009.

Significant developments in the nine months ended September 30, 2010, included an increase in the holdings of our venture capital investments of \$18,755,948 and a decrease in our holdings of U.S. government obligations and cash of \$13,442,599. The increase in the value of our venture capital investments from \$78,023,481 at December 31, 2009, to \$96,779,429 at September 30, 2010, resulted primarily from an increase in the net value of our venture capital investments of \$9,211,992 and by three new and 25 follow-on investments of \$9,667,071. The decrease in the value of our U.S. government obligations and cash from \$57,559,046 at December 31, 2009, to \$44,116,447 at September 30, 2010, is primarily owing to the payment of cash for operating expenses of \$4,165,824 and to new and follow-on venture capital investments totaling \$9,667,071.

The following table is a summary of additions to our portfolio of venture capital investments made during the nine months ended September 30, 2010:

New Investments	Amount of Investment
ABS Materials, Inc.	\$ 250,000
Satcon Technology Corporation	99,957
GEO Semiconductor Inc.	500,000

Follow-On Investments	Amount of Investment
ABS Materials, Inc.	\$ 125,000
Ancora Pharmaceuticals Inc.	500,000
Ancora Pharmaceuticals Inc.	600,000
Ancora Pharmaceuticals Inc.	400,000
BioVex Group, Inc.	354,390
BioVex Group, Inc.	323,077
Bridgelux, Inc.	250,041
D-Wave Systems, Inc.	580,257
Kovio, Inc.	526,225
Laser Light Engines, Inc.	250,000
Laser Light Engines, Inc.	250,000
Laser Light Engines, Inc.	40,000
Laser Light Engines, Inc.	90,000
Laser Light Engines, Inc.	910,000
Mersana Therapeutics, Inc.	87,500
Mersana Therapeutics, Inc.	84,475
Nanosys, Inc.	496,573
NeoPhotonics Corporation	2,455
NeoPhotonics Corporation	2,109
Orthovita, Inc.	98,427
Satcon Technology Corporation	22,134
Satcon Technology Corporation	27,960
SiOnyx, Inc.	339,760
SiOnyx, Inc.	956,740
Solazyme, Inc.	1,499,991

Total	\$	9,667,071
-------	----	-----------

69

---



The following tables summarize the values of our portfolios of venture capital investments and U.S. government obligations, as compared with their cost, at September 30, 2010, and December 31, 2009:

	September 30, 2010	December 31, 2009
Venture capital investments, at cost	\$ 98,387,322	\$ 92,389,907
Net unrealized depreciation(1)	1,607,893	14,366,426
Venture capital investments, at value	\$ 96,779,429	\$ 78,023,481

	September 30, 2010	December 31, 2009
U.S. government obligations, at cost	\$ 43,861,592	\$ 55,960,024
Net unrealized depreciation(1)	1,248	12,443
U.S. government obligations, at value	\$ 43,860,344	\$ 55,947,581

(1) At September 30, 2010, and December 31, 2009, the net accumulated unrealized depreciation on investments was \$1,609,141 and \$14,378,869, respectively.

### Liquidity

Our liquidity and capital resources are generated and generally available through our cash holdings, interest earned on our investments on U.S. government securities, cash flows from the sales of U.S. government securities, proceeds from periodic follow-on equity offerings and realized capital gains retained for reinvestment.

We fund our day-to-day operations using interest earned and proceeds from the sales of our investments in U.S. government securities. The increase or decrease in the valuations of our portfolio companies does not impact our daily liquidity. At September 30, 2010, and December 31, 2009, we had no investments in money market mutual funds. We have no debt outstanding, and, therefore, are not subject to credit agency downgrades.

As a venture capital company, it is critical that we have capital available to support our best companies until we have an opportunity for liquidity in our investments. As such, we will continue to maintain a substantial amount of liquid capital on our balance sheet and will not put the company in a position where we must raise capital through additional equity financings to continue operations. However, to complement our private portfolio investing, we seek to invest some of this capital in publicly traded companies and debt where we will have greater liquidity and more defined investment return timelines, respectively, than we currently have in our existing portfolio. In addition, in the future, we may from time to time opt to borrow money to make investments, specifically in debt securities that generate cash flow and have a known timeframe for return on investment.



At September 30, 2010, and December 31, 2009, our total net primary liquidity was \$44,150,472 and \$57,642,233, respectively. Our primary liquidity is comprised of our cash, U.S. government securities, receivables from unsettled trades, receivables from portfolio companies and interest receivables. The decrease in our primary liquidity from December 31, 2009, to September 30, 2010, is primarily owing to the use of funds for investments and payment of net operating expenses.

At September 30, 2010, and December 31, 2009, our secondary liquidity was \$0 and \$226,395, respectively. Our secondary liquidity consists of our publicly traded securities. Although these companies are publicly traded, their stock may not trade at high volumes and prices can be volatile, which may restrict our ability to sell our positions at any given time.

Although we cannot predict future market conditions, we continue to believe that our current cash and U.S. government security holdings, our strategy to invest in more publicly traded companies and debt and our ability to adjust our investment pace will provide us with adequate liquidity to execute our current business strategy.

Except for a rights offering, we are also generally not able to issue and sell our common stock at a price below our NAV per share, exclusive of any distributing commission or discount, without shareholder approval. As of September 30, 2010, our NAV per share was \$4.51 per share and our closing market price was \$4.27 per share. We do not currently have shareholder approval to issue or sell shares below our NAV per share.

#### Capital Resources

On October 9, 2009, we completed the sale of 4,887,500 shares of our common stock at a price of \$4.75 per share to the public for total gross proceeds of \$23,215,625; net proceeds of this offering, after deducting underwriting discounts and offering costs of \$2,000,413, were \$21,215,212. We intend to use, and have been using, the net proceeds of this offering to make new investments in nanotechnology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through September 30, 2010, we have used \$19,429,844 of the net proceeds from this offering for these purposes.

#### Critical Accounting Policies

The Company's significant accounting policies are described in Note 3 to the Consolidated Financial Statements and in the Footnote to the Consolidated Schedule of Investments. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and those that require management's most difficult, complex or subjective judgments. The Company considers the following accounting policies and related estimates to be critical:

#### 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 in primarily illiquid securities that generally have no established trading market.

Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the SEC and GAAP. 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) the fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments.") As of September 30, 2010, our financial statements include privately held venture capital investments valued at \$96,779,429, the fair values of which were determined in good faith by, or under the direction of, the Board of Directors. As of September 30, 2010, approximately 69.5 percent of our net assets represent investments in portfolio companies valued at fair value by the Board of Directors.

Determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment, although our valuation policy is intended to provide a consistent basis for determining fair value of the portfolio investments. Factors that may be considered include, but are not limited to, readily available public market quotations; the cost of the Company's investment; transactions in the portfolio company's securities or unconditional firm offers by responsible parties; the financial condition and operating results of the company; the long-term potential of the business and technology of the company; the values of similar securities issued by companies in similar businesses; multiples to revenues, net income or EBITDA that similar securities issued by companies in similar businesses receive; the proportion of the company's securities we own and the nature of any rights to require the company to register restricted securities under the applicable securities laws; the achievement of milestones; and the rights and preferences of the class of securities we own as compared with other classes of securities the portfolio has issued.

The difficult economic environment continues to make it extremely difficult for many companies to raise capital. Moreover, the cost of capital has increased substantially. Historically, difficult economic environments have resulted in weak companies not receiving financing and being subsequently closed down with a loss of investment to venture investors, and/or strong companies receiving financing but at significantly lower valuations than the preceding rounds, leading to very deep dilution for those who do not participate in the new rounds of investment. Our best estimate of this non-performance risk has been quantified and included in the valuation of our portfolio companies as of September 30, 2010.

All investments recorded at fair value are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels related to the amount of subjectivity associated with the inputs to fair valuation of these assets, are as follows:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2: Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3: Unobservable inputs for the asset or liability.

As of September 30, 2010, all of our privately held portfolio investments were classified as Level 3 in the hierarchy, indicating a high level of judgment required in their valuation.

The values assigned to our assets are based on available information and do not necessarily represent amounts that might ultimately be realized, as these amounts depend on future circumstances and cannot be reasonably determined until the individual investments are actually liquidated or become readily marketable. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. This difference could be material.

#### Stock-Based Compensation

Determining the appropriate fair-value model and calculating the fair value of share-based awards on the date of grant requires judgment. Historically, we have used the Black-Scholes-Merton option pricing model to estimate the fair value of employee stock options.

Management uses the Black-Scholes-Merton option pricing model in instances where we lack historical data necessary for more complex models and when the share award terms can be valued within the model. Other models may yield fair values that are significantly different from those calculated by the Black-Scholes-Merton option pricing model.

Management uses a binomial lattice option pricing model in instances where it is necessary to include a broader array of assumptions. We used the binomial lattice model for the 10-year NQSOs granted on March 18, 2009. These awards included accelerated vesting provisions that were based on market conditions. At the date of the grant, management's analysis concluded that triggering of the market condition acceleration clause was probable.

Option pricing models require the use of subjective input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. Variations in the expected volatility or expected term assumptions have a significant impact on fair value. As the volatility or expected term assumptions increase, the fair value of the stock option increases. The expected dividend rate and expected risk-free rate of return are not as significant to the calculation of fair value. A higher assumed dividend rate yields a lower fair value, whereas higher assumed interest rates yield higher fair values for stock options.

In the Black-Scholes-Merton model, we use the simplified calculation of expected term as described in the SEC's Staff Accounting Bulletin 107 because of the lack of historical information about option exercise patterns. In the binomial lattice model, we use an expected term that assumes the options will be exercised at two-times the strike price because of the lack of option exercise patterns. Future exercise behavior could be materially different than that which is assumed by the model.

Expected volatility is based on the historical fluctuations in the Company's stock. The Company's stock has historically been volatile, which increases the fair value of the underlying share-based awards.

GAAP requires us to develop an estimate of the number of share-based awards that will be forfeited owing to employee turnover. Quarterly changes in the estimated forfeiture rate can have a significant effect on reported share-based compensation, as the effect of adjusting the rate for all expense amortization after the grant date is recognized in the period the forfeiture estimate is changed. If the actual forfeiture rate proves to be higher than the estimated forfeiture rate, then an adjustment will be made to increase the estimated forfeiture rate, which would result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate proves to be lower than the estimated forfeiture rate, then an adjustment will be made to decrease the estimated forfeiture rate, which would result in an increase to the expense recognized in the financial statements. Such adjustments would affect our operating expenses and additional paid-in capital, but would have no effect on our NAV.



#### Pension and Post-Retirement Benefit Plan Assumptions

The Company provides a Retiree Medical Benefit Plan for employees who meet certain eligibility requirements. The Company also provides an Executive Mandatory Retirement Benefit Plan for certain individuals employed by us in a bona fide executive or high policy-making position. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability values related to our post-retirement benefit plans. These factors include assumptions we make about the discount rate, the rate of increase in healthcare costs, and mortality, among others.

The discount rate reflects the current rate at which the post-retirement medical benefit and pension liabilities could be effectively settled considering the timing of expected payments for plan participants. In estimating this rate, we consider the Citigroup Pension Liability Index in the determination of the appropriate discount rate assumptions. The weighted average rate we utilized to measure our post retirement medical benefit obligation as of December 31, 2009, and to calculate our 2010 expense was 5.72 percent. We used a discount rate of 5.75 percent to calculate our pension obligation for the Executive Mandatory Retirement Benefit Plan.

#### Recent Developments - Portfolio Companies

On October 27, 2010, we made a \$300,000 follow-on investment in a privately held tiny technology portfolio company.

#### Forward-Looking Statements

The information contained herein may contain "forward-looking statements" based on our current expectations, assumptions and estimates about us and our industry. These forward-looking statements involve risks and uncertainties. Words such as "believe," "anticipate," "estimate," "expect," "intend," "plan," "will," "may," "might," "could," "continue" and other similar expressions identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of several factors more fully described in "Risk Factors" and elsewhere in this Form 10-Q, and in our Form 10-K for the year ended December 31, 2009. The forward-looking statements made in this Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our business activities contain elements of risk. We consider the principal types of market risk to be valuation risk, interest rate risk and foreign currency risk. Although we are risk-seeking rather than risk-averse in our investments, we consider the management of risk to be essential to our business.

#### Valuation Risk

Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which market quotations are readily available and (ii) fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See the "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments" contained in "Item 1. Consolidated Financial Statements.")

Because there is typically no public market for our interests in the small privately held companies in which we invest, the valuation of the equity interests in that portion of our portfolio is determined in good faith by our Valuation Committee, comprised of the independent members of our Board of Directors, in accordance with our Valuation Procedures. In the absence of a readily ascertainable market value, the determined value of our portfolio of equity interests may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests existed. Determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment, although our valuation policy is intended to provide a consistent basis for determining fair value of the portfolio investments. Factors that may be considered include, but are not limited to, readily available public market quotations; the cost of the Company's investment; transactions in the portfolio company's securities or unconditional firm offers by responsible parties; the financial condition and operating results of the company; the long-term potential of the business and technology of the company; the values of similar securities issued by companies in similar businesses; multiples to revenues, net income or EBITDA that similar securities issued by companies in similar businesses receive; the proportion of the company's securities we own and the nature of any rights to require the company to register restricted securities under the applicable securities laws; the achievement of milestones; and the rights and preferences of the class of securities we own as compared with other classes of securities the portfolio has issued. Any changes in valuation are recorded in our Consolidated Statements of Operations as "Net decrease in unrealized depreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

Investments in privately held, immature companies are inherently more volatile than investments in more mature businesses. Such immature businesses are inherently fragile and easily affected by both internal and external forces. Our investee companies can lose much or all of their value suddenly in response to an internal or external adverse event. Conversely, these immature businesses can gain suddenly in value in response to an internal or external positive development.

The values assigned to our assets are based on available information and do not necessarily represent amounts that might ultimately be realized, as these amounts depend on future circumstances and cannot be reasonably determined until the individual investments are actually liquidated or become readily marketable. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. This difference could be material.



### Interest Rate Risk

We generally also invest in both short and long-term U.S. government and agency securities. To the extent that we invest in short and long-term U.S. government and agency securities, changes in interest rates result in changes in the value of these obligations that result in an increase or decrease of our NAV. The level of interest rate risk exposure at any given point in time depends on the market environment, the expectations of future price and market movements, and the quantity and duration of long-term U.S. government and agency securities held by the Company, and it will vary from period to period. If the average interest rate on U.S. government securities at September 30, 2010, were to increase by 25, 75 and 150 basis points, the average value of these securities held by us at September 30, 2010, would decrease by approximately \$109,651, \$328,953 and \$657,905, respectively, and our NAV would decrease correspondingly.

In addition, market interest rates for high-yield corporate debt are an input in determining value of our investments in debt securities of privately held and publicly traded companies. Significant changes in these market rates could affect the value of our debt securities as of the date of measurement of value. Our investment income could be adversely affected should such debt securities include floating interest rates. We do not currently have any investments in debt securities with floating interest rates.

In the future, we may from time to time opt to borrow money to make investments. Our net investment income will be dependent upon the difference between the rate at which we borrow funds and the rate at which we invest such funds. As a result, there can be no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income in the event we choose to borrow funds for investing purposes.

### Foreign Currency Risk

Most of our investments are denominated in U.S. dollars. We currently have one investment denominated in Canadian dollars. We are exposed to foreign currency risk related to potential changes in foreign currency exchange rates. The potential loss in fair value on this investment resulting from a 10 percent adverse change in quoted foreign currency exchange rates is \$374,905 at September 30, 2010.

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures. As of the end of the period covered by this report, the Company's management, under the supervision and with the participation of our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as required by Rules 13a-15 of the 1934 Act). Disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the 1934 Act is recorded, processed, summarized and reported, within time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the issuer's management, as appropriate, to allow timely decisions regarding required disclosures. As of September 30, 2010, based upon this evaluation of our disclosure controls and procedures, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective.

(b) Changes in Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the 1934 Act) during the third quarter of 2010 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1A. Risk Factors

Investing in our common stock involves significant risks relating to our business and investment objective. You should carefully consider the risks and uncertainties described in our Annual Report on Form 10-K for the year ended December 31, 2009, before you purchase any of our common stock.

The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Unknown additional risks and uncertainties, or ones that we currently consider immaterial, may also impair our business. If any of these risks or uncertainties materialize, our business, financial condition or results of operations could be materially adversely affected. In this event, the trading price of our common stock could decline, and you could lose all or part of your investment. In addition to the risks described in our Annual Report on Form 10-K, you should also consider the following risks:

The market price of our shares of common stock may be adversely affected by the sale of shares by our management or founding stockholder.

Sales of our shares of common stock by our officers through 10b5-1 plans or by our founding stockholder could adversely and unpredictably affect the price of those securities. Additionally, the price of our shares of common stock could be affected even by the potential for sales by these persons. We cannot predict the effect that any future sales of our common stock, or the potential for those sales, will have on our share price. Furthermore, due to relatively low trading volume of our stock, should one or more large stockholders seek to sell a significant portion of its stock in a short period of time, the price of our stock may decline.

Our portfolio companies face risks associated with international sales.

We anticipate that certain of our portfolio companies could generate revenue from international sales. Risks associated with these potential future sales include:

- Political and economic instability;
- Export controls and other trade restrictions;
- Changes in legal and regulatory requirements;
- U.S. and foreign government policy changes affecting the markets for the technologies;
  - Changes in tax laws and tariffs;
- Convertibility and transferability of international currencies; and
- International currency exchange rate fluctuations.

Any of these factors could have a material adverse effect on the business, results of operations and financial condition of our portfolio companies. Currency exchange rate fluctuations may negatively affect the cost of portfolio company products to international customers and, therefore, reduce their competitive position.

Item 5.

Exhibits

3(i) Certificate of Change of the Certificate of Incorporation of Harris & Harris Group, Inc., dated August 5, 2010, incorporated by reference as Exhibit 3 to Form 8-K (File No. 814-00176) filed on August 6, 2010.

31.01\* Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.02\* Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32\* Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\*filed herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Harris & Harris Group, Inc.

/s/ Daniel B. Wolfe  
By: Daniel B. Wolfe  
Chief Financial Officer

/s/ Patricia N. Egan  
By: Patricia N. Egan  
Chief Accounting Officer  
and Vice President

Date: November 8, 2010

EXHIBIT INDEX

Exhibit No.	Description
31.01	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.