HARRIS & HARRIS GROUP INC /NY/
Form 10-Q
November 08, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2012

¨ 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 x 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 x
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 x

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, 2012
Common Stock, $0.01 par value per share	31,000,601 shares

Harris & Harris Group, Inc.

Form 10-Q, September 30, 2012

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 fair 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, 2011.

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Investments, in portfolio securities at value:		
Unaffiliated privately held companies (cost: $28,812,415 and $23,794,145, respectively)	$ 29,279,753	$ 23,748,247
Unaffiliated rights to milestone payments (adjusted cost basis: $3,291,750 and $3,291,750, respectively)	3,400,488	3,362,791
Unaffiliated publicly traded securities (cost: $11,879,859 and $12,743,787, respectively)	24,903,100	29,484,527
Non-controlled affiliated privately held companies (cost: $51,924,083 and $48,968,029, respectively)	58,722,585	47,601,785
Non-controlled affiliated publicly traded companies (cost: $2,000,000 and $2,000,000, respectively)	1,314,667	1,973,334
Controlled affiliated privately held companies (cost: $14,243,460 and $12,518,936, respectively)	6,256,363	6,877,566
Total, investments in private portfolio companies, rights to milestone payments and public securities at value (cost: $112,151,567 and $103,316,647, respectively)	$ 123,876,956	$ 113,048,250
Investments in U.S. Treasury obligations, at value (cost: $9,999,914 and $0, respectively)	10,000,000	0
Cash	16,556,886	33,841,394
Restricted funds (Note 3)	2,010,010	1,512,031
Funds held in escrow from sales of investments, at value (Note 3)	588,276	1,064,234
Receivable from portfolio company	49,288	37,331
Receivable from unsettled trade	64,185	0
Interest receivable	13,911	14,635
Prepaid expenses	145,235	398,858
Other assets	391,966	426,920
Total assets	$ 153,696,713	$ 150,343,653
LIABILITIES & NET ASSETS		
Post retirement plan liabilities	$ 1,818,490	$ 1,660,958
Revolving loan (Note 5)	2,000,000	1,500,000
Accounts payable and accrued liabilities	972,269	906,910
Deferred rent	377,000	378,980
Written call options payable (premiums received: $1,011,413 and $315,000, respectively) (Note 7)	364,080	195,000
Debt interest and other payable	4,497	3,398
Total liabilities	5,536,336	4,645,246

Net assets	$ 148,160,377	$ 145,698,407
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 9/30/12 and 12/31/11; 32,829,341 issued at 9/30/12 and 12/31/11	328,294	328,294
Additional paid in capital (Note 8)	212,927,792	210,470,369
Accumulated net operating and realized loss	(74,062,986)	(71,546,328)
Accumulated unrealized appreciation of investments	12,372,808	9,851,603
Treasury stock, at cost (1,828,740 shares at 9/30/12 and 12/31/11)	(3,405,531)	(3,405,531)
Net assets	$ 148,160,377	$ 145,698,407
Shares outstanding	31,000,601	31,000,601
Net asset value per outstanding share	$ 4.78	$ 4.70

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended Sept. 30, 2012	Three Months Ended Sept. 30, 2011	Nine Months Ended Sept. 30, 2012	Nine Months Ended Sept. 30, 2011
Investment income:				
Interest from:				
Unaffiliated companies	$ 64,019	$ 69,569	$ 185,340	$ 196,806
Non-controlled affiliated companies	236,695	30,715	86,319	101,412
Controlled affiliated companies	44,042	51,844	111,043	127,574
Cash and U.S. Treasury obligations	5,213	9,490	17,910	31,270
Miscellaneous income	46,277	40,909	128,078	70,115
Total investment income	396,246	202,527	528,690	527,177
Expenses:				
Salaries, benefits and stock-based compensation (Note 8)	1,200,902	1,490,116	5,148,293	4,073,995
Administration and operations	212,917	207,491	795,143	683,292
Professional fees	222,467	413,156	740,106	869,717
Rent	105,705	99,323	303,402	278,323
Directors' fees and expenses	63,015	80,387	240,747	264,559
Custody fees	13,653	4,380	35,635	52,380
Depreciation	15,020	12,729	43,618	37,895
Interest and other debt expense	12,901	13,103	36,741	26,870
Total expenses	1,846,580	2,320,685	7,343,685	6,287,031
Net operating loss	(1,450,334)	(2,118,158)	(6,814,995)	(5,759,854)
Net realized gain (loss):				
Realized gain (loss) from investments:				
Unaffiliated companies	0	(2,017,949)	476,887	5,310,794
Non-Controlled affiliated companies	354	(665,269)	11,775	(2,631,859)
Publicly traded companies	2,695,339	0	3,366,218	0
Written call options	80,573	0	458,911	0
U.S. Treasury obligations/other	(218)	0	(218)	(82)
Realized gain (loss) from investments	2,776,048	(2,683,218)	4,313,573	2,678,853
Income tax expense (Note 9)	7,161	1,250	15,236	3,643
Net realized gain (loss) from investments	2,768,887	(2,684,468)	4,298,337	2,675,210
Net (decrease) increase in unrealized appreciation on investments:				
Change as a result of investment sales	(3,616,482)	2,663,050	(4,287,361)	(2,015,594)
Change on investments held	(2,483,303)	(30,945,031)	6,281,233	(7,888,307)

Change on written call options	1,111,515	0	527,333	0
Net (decrease) increase in unrealized appreciation on investments	(4,988,270)	(28,281,981)	2,521,205	(9,903,901)
Net realized and unrealized (loss) gain on investments	(2,219,383)	(30,966,449)	6,819,542	(7,228,691)
Net (decrease) increase in net assets resulting from operations:				
Total	$ (3,669,717)	$ (33,084,607)	$ 4,547	$ (12,988,545)
Per average basic and diluted outstanding share	$ (0.12)	$ (1.07)	$ 0.00	$ (0.42)
Average outstanding shares - basic	31,000,601	31,000,601	31,000,601	30,973,353
Average outstanding shares - diluted	31,000,601	31,000,601	31,000,681	30,973,353

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011 (Corrected)
Cash flows used in operating activities:		
Net increase (decrease) in net assets resulting from operations	$ 4,547	$ (12,988,545)
Adjustments to reconcile net increase in net assets resulting from operations to net cash (used in) provided by operating activities:		
Net realized (gain) loss and (increase) decrease in unrealized appreciation on investments	(6,834,778)	7,225,048
Depreciation of fixed assets, amortization of premium or discount on U.S. government securities, and bridge note interest	(168,346)	(238,886)
Stock-based compensation expense	2,457,423	1,427,321
Purchase of U.S. government securities	(9,999,356)	(100,032,726)
Sale of U.S. government securities	0	125,682,274
Purchase of affiliated portfolio companies	(8,242,326)	(12,465,603)
Purchase of unaffiliated portfolio companies	(1,575,514)	(3,732,015)
Principal payments received on debt investments	331,264	1,523,736
Proceeds from sale of investments	5,062,210	12,804,733
Proceeds from call option premiums	2,654,935	0
Payments for call option purchases	(1,367,364)	0
Changes in assets and liabilities:		
Restricted funds	(497,979)	(1,262,025)
Receivable from portfolio company	(11,957)	(4,500)
Receivable from unsettled trades	(64,185)	0
Interest receivable	165	24,402
Income tax receivable	7,161	1,185
Prepaid expenses	253,623	252,393
Other assets	(525)	8,366
Post retirement plan liabilities	157,532	89,733
Accounts payable and accrued liabilities	66,458	491,235
Deferred rent	(1,980)	2,772
Net cash (used in) provided by operating activities	(17,768,992)	18,808,898
Cash flows from investing activities:		
Purchase of fixed assets	(15,516)	(4,071)
Net cash used in investing activities	(15,516)	(4,071)

Cash flows from financing activities:		
Proceeds from stock option exercises	0	491,058
Proceeds from drawdown of credit facility	500,000	1,250,000
Net cash provided by financing activities	500,000	1,741,058
Net increase (decrease) in cash:		
Cash at beginning of the period	33,841,394	3,756,919
Cash at end of the period	16,556,886	24,302,804
Net (decrease) increase in cash	$ (17,284,508)	$ 20,545,885
Supplemental disclosures of cash flow information:		
Income taxes paid	$ 8,075	$ 2,458
Interest paid	$ 21,158	$ 14,303

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

	Nine Months Ended September 30, 2012 (Unaudited)	Year Ended December 31, 2011
Changes in net assets from operations:		
Net operating loss	$ (6,814,995)	$ (8,338,365)
Net realized gain on investments	4,298,337	2,449,705
Net (decrease) increase in unrealized appreciation on investments as a result of sales	(4,287,361)	74,649
Net increase in unrealized appreciation on investments held	6,281,233	2,152,648
Net increase in unrealized appreciation on written call options	527,333	120,000
Net increase (decrease) in net assets resulting from operations	4,547	(3,541,363)
Changes in net assets from capital stock transactions:		
Issuance of common stock upon the exercise of stock options	0	1,224
Additional paid in capital on common stock issued net of offering expenses	0	489,834
Stock-based compensation expense	2,457,423	1,894,800
Net increase in net assets resulting from capital stock transactions	2,457,423	2,385,858
Net increase (decrease) in net assets	2,461,970	(1,155,505)
Net Assets:		
Beginning of the period	145,698,407	146,853,912
End of the period	$ 148,160,377	$ 145,698,407

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 38.9% of net assets at value					
Private Placement Portfolio (Illiquid) (4) – 19.8% of net assets at value					
Bridgelux, Inc. (7)(8)		Energy			
Manufacturing high-power light emitting diodes (LEDs) and arrays					
Series B Convertible Preferred Stock	(M)		$1,000,000	1,861,504	$1,244,490
Series C Convertible Preferred Stock	(M)		1,352,196	2,130,699	1,776,485
Series D Convertible Preferred Stock	(M)		1,371,622	999,999	1,570,301
Series E Convertible Preferred Stock	(M)		672,599	440,334	858,734
Series E-1 Convertible Preferred Stock	(M)		534,482	399,579	584,309
Warrants for Series C Convertible Preferred Stock expiring 12/31/14	(I)		168,270	163,900	48,013
Warrants for Series D Convertible Preferred Stock expiring 8/26/14	(I)		88,531	124,999	61,111
Warrants for Series D Convertible Preferred Stock expiring 3/10/15	(I)		40,012	41,666	20,370
Warrants for Series E Convertible Preferred Stock expiring 12/31/17	(I)		93,969	170,823	101,019
Warrants for Common Stock expiring 6/1/16	(I)		72,668	132,100	9
Warrant for Common Stock expiring 10/21/18	(I)		18,816	84,846	6
			5,413,165		6,264,847
Cambrios Technologies Corporation (7)(9)(10)		Electronics			
Developing nanowire-enabled electronic materials for the display industry					
Series B Convertible Preferred Stock	(M)		1,294,025	1,294,025	1,165,383
Series C Convertible Preferred Stock	(M)		1,300,000	1,300,000	1,170,764
Series D Convertible Preferred Stock	(M)		515,756	515,756	773,634
Series D-2 Convertible Preferred Stock	(M)		92,400	92,400	92,400
Series D-4 Convertible Preferred Stock	(M)		216,168	216,168	216,168
			3,418,349		3,418,349
Cobalt Technologies, Inc. (7)(9)(11)		Energy			

Developing processes for making bio- butanol through biomass fermentation				
Series C-1 Convertible Preferred Stock	(M)	749,998	352,112	930,400
Series D-1 Convertible Preferred Stock	(M)	122,070	48,828	140,109
Secured Convertible Bridge Note, 10%, acquired 5/25/12	(M)	46,691	$45,097	46,691
		918,759		1,117,200

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 38.9% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) – 19.8% of net assets at value (Cont.)					
Ensemble Therapeutics Corporation (7)(9)(12) Developing DNA-Programmed Chemistry™ for the discovery of new classes of therapeutics		Healthcare			
Series B Convertible Preferred Stock	(M)		$2,000,000	1,449,275	$0
Secured Convertible Bridge Note, 8%, acquired 9/11/08	(M)		331,505	$250,211	1,563,296
Secured Convertible Bridge Note, 8%, acquired 12/10/09	(M)		59,872	$48,868	300,451
Secured Convertible Bridge Note, 8%, acquired 1/25/12	(M)		115,428	$109,400	654,006
			2,506,805		2,517,753
GEO Semiconductor Inc. (13) Developing programmable, high-performance video and geometry processing solutions		Electronics			
Participation Agreement with Montage Capital relating to the following assets:					
Senior secured debt, 13.75%, maturing on 11/30/12	(I)		314,769	$406,851	388,220
Warrants for Series A Pref. Stock expiring on 9/17/17	(I)		66,684	100,000	69,540
Warrants for Series A-1 Pref. Stock expiring on 6/30/18	(I)		23,566	34,500	24,417
Loan and Security Agreement with GEO Semiconductor relating to the following assets:					
Subordinated secured debt, 15.75%, maturing on 11/30/12	(I)		108,587	$125,000	123,420
Warrants for Series A Pref. Stock expiring on 3/1/18	(I)		7,512	10,000	6,501
Warrants for Series A-1 Pref. Stock expiring on 6/29/18	(I)		7,546	10,000	6,523

			528,664		618,621
Mersana Therapeutics, Inc. (7)(9)(14)		Healthcare			
Developing treatments for cancer based on novel drug delivery polymers					
Series A-1 Convertible Preferred Stock	(M)		316,453	294,019	316,453
Common Stock	(M)		3,875,395	350,539	172,816
			4,191,848		489,269
Molecular Imprints, Inc. (7)(15)		Electronics			
Manufacturing nanoimprint lithography capital equipment					
Series B Convertible Preferred Stock	(M)		2,000,000	1,333,333	1,789,108
Series C Convertible Preferred Stock	(M)		2,406,595	1,285,071	2,138,498
Non-Convertible Bridge Note	(I)		0	$0	3,033,338
			4,406,595		6,960,944

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 38.9% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) – 19.8% of net assets at value (Cont.)					
Nanosys, Inc. (7)		Energy			
Developing inorganic nanowires and quantum dots for use in batteries and LED-backlit devices					
Series C Convertible Preferred Stock	(M)		$1,500,000	803,428	$143,903
Series D Convertible Preferred Stock	(M)		3,000,003	1,016,950	2,812,469
Series E Convertible Preferred Stock	(M)		496,573	433,688	698,298
Unsecured Convertible Bridge Note, 4%, acquired 7/16/12	(M)		44,191	$43,821	248,890
			5,040,767		3,903,560
NanoTerra, Inc. (9)		Energy			
Developing surface chemistry and nano-manufacturing solutions					
Senior secured debt, 12.0%, maturing on 2/22/14	(I)		201,796	$258,445	254,360
Senior secured debt, 12.0%, maturing on 2/22/13	(I)		44,597	$57,117	56,922
Warrants for Series A-2 Pref. Stock expiring on 2/22/21	(I)		69,168	446,248	66,390
			315,561		377,672
Nantero, Inc. (7)(9)(10)		Electronics			
Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes					
Series A Convertible Preferred Stock	(M)		489,999	345,070	1,349,224
Series B Convertible Preferred Stock	(M)		323,000	207,051	809,569
Series C Convertible Preferred Stock	(M)		571,329	188,315	736,312
			1,384,328		2,895,105
OHSO Clean, Inc. (16)(17)		Healthcare			

Developing natural, hypoallergenic household cleaning products enabled by nanotechnology- enabled formulations of thyme oil				
Participation Agreement with Montage Capital relating to the following assets:				
Senior secured debt, 13.00%, maturing on 9/30/14	(I)	595,832	$697,920	625,800
Warrants for Series C Pref. Stock expiring on 3/30/22	(I)	91,742	1,109,333	90,633
		687,574		716,433
Total Unaffiliated Private Placement Portfolio (cost: $28,812,415)				$29,279,753

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Rights to Milestone Payments (Illiquid) (5) – 2.3% of net assets at value					
Amgen, Inc. (7)(10)		Healthcare			
Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	(I)		$3,291,750	$3,291,750	$3,400,488
Total Unaffiliated Rights to Milestone Payments (cost: $3,291,750)					$3,400,488
Publicly Traded Portfolio (6) – 16.8% of net assets at value					
NeoPhotonics Corporation (10)(18)		Electronics			
Developing and manufacturing optical devices and components					
Common Stock	(M)		$7,299,590	450,907	$2,633,297
Solazyme, Inc. (10)(19)		Energy			
Developing algal biodiesel, industrial chemicals and specialty ingredients using synthetic biology					
Common Stock	(M)		4,580,269	1,938,190	22,269,803
Total Unaffiliated Publicly Traded Portfolio (cost: $11,879,859)					$24,903,100
Total Investments in Unaffiliated Companies (cost: $43,984,024)					$57,583,341

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 40.5% of net assets at value					
Private Placement Portfolio (Illiquid) (20) – 39.6% of net assets at value					
ABSMaterials, Inc. (7)(9)(10)		Energy			
Developing nano-structured absorbent materials for environmental remediation					
Series A Convertible Preferred Stock	(M)		$435,000	390,000	$1,170,000
Adesto Technologies Corporation (7)(9)(10)		Electronics			
Developing low-power, high-performance memory devices					
Series A Convertible Preferred Stock	(M)		2,200,000	6,547,619	6,220,239
Series B Convertible Preferred Stock	(M)		2,200,000	5,952,381	5,654,762
Series C Convertible Preferred Stock	(M)		1,485,531	2,122,187	2,016,078
Series D Convertible Preferred Stock	(M)		1,393,147	1,466,470	1,393,147
			7,278,678		15,284,226
Contour Energy Systems, Inc. (7)(9)(10)		Energy			
Developing batteries using nanostructured materials					
Series A Convertible Preferred Stock	(M)		2,009,995	2,565,798	1,806,192
Series B Convertible Preferred Stock	(M)		1,300,000	812,500	981,004
Series C Convertible Preferred Stock	(M)		1,200,000	1,148,325	1,050,000
			4,509,995		3,837,196
D-Wave Systems, Inc. (7)(9)(21)		Electronics			
Developing high-performance quantum computing systems					
Series 1 Class B Convertible Preferred Stock	(M)		1,002,074	1,144,869	1,513,173
Series 1 Class C Convertible Preferred Stock	(M)		487,804	450,450	595,360
Series 1 Class D Convertible Preferred Stock	(M)		748,473	855,131	1,130,227
Series 1 Class E Convertible Preferred Stock	(M)		248,049	269,280	355,907
Series 1 Class F Convertible Preferred Stock	(M)		238,323	258,721	341,952
Series 2 Class D Convertible Preferred Stock	(M)		736,019	678,264	896,462
Series 2 Class E Convertible Preferred Stock	(M)		409,032	317,746	419,965

Series 2 Class F Convertible Preferred Stock	(M)	392,993	305,286	403,496
Warrants for Common Stock expiring 6/30/15	(I)	98,644	153,890	53,058
		4,361,411		5,709,600

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 40.5% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (20) – 39.6% of net assets at value (Cont.)					
Enumeral Biomedical Corp. (7)(9)(10)		Healthcare			
Developing therapeutics and diagnostics through functional assaying of single cells					
Series A Convertible Preferred Stock	(M)		$1,026,832	957,038	$1,325,507
Series A-1 Convertible Preferred Stock	(M)		750,000	576,923	750,000
			1,776,832		2,075,507
HzO, Inc. (7)(9)(10)		Electronics			
Developing novel industrial coatings that protect electronics against damage from liquids					
Series A Convertible Preferred Stock	(M)		666,667	4,057,294	1,130,362
Series B Convertible Preferred Stock	(M)		1,000,000	3,947,888	1,099,882
			1,666,667		2,230,244
Kovio, Inc. (7)(9)(10)		Electronics			
Developing semiconductor products using printed electronics and thin-film technologies					
Series A' Convertible Preferred Stock	(M)		5,242,993	2,160,000	1,437,286
Series B' Convertible Preferred Stock	(M)		2,006,540	3,015,493	2,006,540
			7,249,533		3,443,826
Metabolon, Inc. (7)(10)		Healthcare			
Developing service and diagnostic products through the use of a metabolomics, or biochemical, profiling platform					
Series B Convertible Preferred Stock	(M)		2,500,000	371,739	1,951,723
Series B-1 Convertible Preferred Stock	(M)		706,214	148,696	780,689
Series C Convertible Preferred Stock	(M)		1,000,000	1,000,000	1,794,510
Series D Convertible Preferred Stock	(M)		1,499,999	835,882	1,499,999
Warrants for Series B-1 Convertible Preferred Stock expiring 3/25/15	(I)		293,786	74,348	54,886

	5,999,999	6,081,807

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 40.5% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (20) – 39.6% of net assets at value (Cont.)					
Nextreme Thermal Solutions, Inc. (7)(9)(10)		Energy			
Developing thin-film thermoelectric devices for cooling and energy conversion					
Common Stock	(M)		$4,384,762	8,080,153	$0
OpGen, Inc. (7)(10)(16)		Healthcare			
Developing tools for genomic sequence assembly and analysis					
Series C Convertible Preferred Stock	(M)		815,000	5,905,797	815,000
Produced Water Absorbents, Inc. (7)(9)(10)		Energy			
Developing nano-stuctured absorbent materials for environmental remediation of contaminated water in the oil and gas industries					
Series A Convertible Preferred Stock	(M)		1,000,000	1,000,000	1,000,000
Senova Systems, Inc. (7)(9)(10)		Healthcare			
Developing next-generation sensors to measure pH					
Series B Convertible Preferred Stock	(M)		1,218,462	1,350,000	810,000
Warrants for Series B Preferred Stock expiring 7/18/17	(I)		131,538	164,423	98,637
			1,350,000		908,637
SiOnyx, Inc. (7)(9)(10)		Electronics			
Developing silicon-based optoelectronic products enabled by its proprietary Black Silicon					
Series A Convertible Preferred Stock	(M)		750,000	233,499	160,367
Series A-1 Convertible Preferred Stock	(M)		890,000	2,966,667	2,037,507
Series A-2 Convertible Preferred Stock	(M)		2,445,000	4,207,537	2,889,736

Series B-1 Convertible Preferred Stock	(M)	1,169,561	1,892,836	1,300,000
Series C Convertible Preferred Stock	(M)	1,171,316	1,674,030	1,255,523
Warrants for Series B-1 Convertible Preferred Stock expiring 2/23/17	(I)	130,439	247,350	60,688
Warrants for Common Stock expiring 3/28/17	(I)	84,207	418,507	38,872
		6,640,523		7,742,693

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 40.5% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (20) – 39.6% of net assets at value (Cont.)					
Ultora, Inc. (7)(9)		Energy			
Developing energy-storage devices enabled by carbon nanotubes					
Series A Convertible Preferred Stock	(M)		$282,821	282,821	$282,821
Secured Convertible Bridge Note, 3%, acquired 7/12/12	(M)		65,082	$64,652	65,082
Secured Convertible Bridge Note, 3%, acquired 9/28/12	(M)		107,780	$107,753	107,780
			455,683		455,683
Xradia, Inc. (7)(10)		Electronics			
Designing, manufacturing and selling ultra-high resolution 3D x-ray microscopes and fluorescence imaging systems					
Series D Convertible Preferred Stock	(M)		4,000,000	3,121,099	7,968,166
Total Non-Controlled Private Placement Portfolio (cost: $51,924,083)					$58,722,585

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 40.5% of net assets at value (Cont.)					
Publicly Traded Portfolio (Illiquid) (22) – 0.09% of net assets at value					
Champions Oncology, Inc. (10) Developing its TumorGraft™ platform for personalized medicine and drug development		Healthcare			
Common Stock	(M)		$2,000,000	2,666,667	$1,314,667
Total Non-Controlled Affiliated Publicly Traded Portfolio (cost: $2,000,000)					$1,314,667
Total Investments in Non-Controlled Affiliated Companies (cost: $53,924,083)					$60,037,252
Investments in Controlled Affiliated Companies (3)(23) – 4.2% of net assets at value					
Private Placement Portfolio (Illiquid) – 4.2% of net assets at value					
Ancora Pharmaceuticals Inc. (7)(9) Developing synthetic carbohydrates for pharmaceutical applications		Healthcare			
Common Stock	(M)		$2,729,817	57,463	$1,724
Series A' Convertible Preferred Stock	(M)		4,855,627	4,855,627	3,641,720
Senior Secured Debt, 12.00%, maturing on 12/11/12	(I)		486,635	$500,000	467,200
			8,072,079		4,110,644

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (3)(23) – 4.2% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) – 4.2% of net assets at value (Cont.)					
Laser Light Engines, Inc. (7)(9) Manufacturing solid-state light sources for digital cinema and large-venue projection displays		Energy			
Series A Convertible Preferred Stock	(M)		$2,000,000	7,499,062	$0
Series B Convertible Preferred Stock	(M)		3,095,802	13,571,848	1,070,140
Secured Convertible Bridge Note, 12%, acquired 10/7/11	(M)		223,671	$200,000	223,671
Secured Convertible Bridge Note, 12%, acquired 11/17/11	(M)		105,684	$95,652	105,684
Secured Convertible Bridge Note, 12%, acquired 12/21/11	(M)		90,349	$82,609	90,349
Secured Convertible Bridge Note, 12%, acquired 3/5/12	(M)		464,802	$434,784	464,802
Secured Convertible Bridge Note, 12%, acquired 7/26/12	(M)		191,073	$186,955	191,073
			6,171,381		2,145,719
Total Controlled Private Placement Portfolio (cost: $14,243,460)					$6,256,363
Total Investments in Controlled Affiliated Companies (cost: $14,243,460)					$6,256,363
Total Private Placement and Publicly Traded Portfolio (cost: $112,151,567)					$123,876,956

	Method of Valuation (1)	Cost	Shares/ Principal	Value

U.S. Government Securities (24) – 6.7% of net assets at value				
U.S. Treasury Bill — due date 10/04/12	(M)	$9,999,914	$10,000,000	$10,000,000
Total Investments in U.S. Government Securities (cost: $9,999,914)				$10,000,000
Total Investments (cost: $122,151,481)				$133,876,956

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

Written Call Options (16)(25) – (0.25)% of net assets at value	Method of Valuation (1)	Number of Contracts	Value
Solazyme, Inc. — Strike Price $12.50, October 20, 2012	(M)	32	$(320)
Solazyme, Inc. — Strike Price $15.00, October 20, 2012	(M)	1,000	(9,000)
Solazyme, Inc. — Strike Price $10.00, December 22, 2012	(M)	74	(12,210)
Solazyme, Inc. — Strike Price $12.50, December 22, 2012	(M)	4,000	(260,000)
Solazyme, Inc. — Strike Price $15.00, December 22, 2012	(M)	2,750	(13,750)
Solazyme, Inc. — Strike Price $17.50, December 22, 2012	(M)	2,000	(10,000)
Solazyme, Inc. — Strike Price $17.50, March 8, 2013	(M)	4,010	(53,800)
NeoPhotonics Corporation — Strike Price $7.50, February 16, 2013	(M)	500	(5,000)
Total Written Call Options (Premiums Received $1,011,413)			$(364,080)

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

Notes to Consolidated Schedule of Investments

(1) See "Footnote to Consolidated Schedule of Investments" on page 33 for a description of the "Valuation Procedures."

(2) We classify "Energy" 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" companies as those that use nanotechnology to address problems in electronics-related industries, including semiconductors. We classify "Healthcare" companies as those that use nanotechnology to address problems in healthcare-related industries, including biotechnology, pharmaceuticals and medical devices.

(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 $28,812,415. The gross unrealized appreciation based on the tax cost for these securities is $5,307,124. The gross unrealized depreciation based on the tax cost for these securities is $4,839,786.

(5) The aggregate cost for federal income tax purposes of investments in unaffiliated rights to milestone payments is $3,291,750. The gross unrealized appreciation based on the tax cost for these securities is $108,738. The gross unrealized depreciation based on the tax cost for these securities is $0.

(6) The aggregate cost for federal income tax purposes of investments in unaffiliated publicly traded companies is $11,879,859. The gross unrealized appreciation based on the tax cost for these securities is $17,689,534. The gross unrealized depreciation based on the tax cost for these securities is $4,666,293.

(7) We are subject to legal restrictions on the sale of our investment(s) in this company.

(8) With the conversion of our bridge note into shares of Series E-1 Preferred Stock, we received a warrant to purchase shares of common stock at $0.25 per share. The number of shares is determined by certain financial targets for 2012 set upon receipt of the audited financial statements for 2012. Should the company complete a sale or an IPO prior to the end of 2012, the warrant will become void.

(9) 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.

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

(10) 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.

(11) Cobalt Technologies, Inc., also does business as Cobalt Biofuels.

(12) With our investment in a convertible bridge note issued by Ensemble Therapeutics Corporation, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of Ensemble Therapeutics Corporation equal to $149,540 divided by the price per share of the class of stock sold in the next financing of Ensemble Therapeutics Corporation. The ability to exercise this warrant is, therefore, contingent on Ensemble Therapeutics Corporation 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.

(13) The maturity dates of the senior secured debt and the subordinated secured debt are expected to be extended to the end of 2012 or 2013. As such, the notes were not repaid on September 28, 2012.

(14) With our investment in the Mersana Therapeutics, Inc., Series A-1 financing, we received a warrant to purchase 277,760 shares of Series A-2 Convertible Preferred Stock. The purchase price and exercise dates of the warrant are contingent upon Mersana's achievement of certain milestones. The warrant will expire on July 27, 2022.

(15) As part of a loan the Company made to Molecular Imprints in the second quarter of 2011, we received a liquidation preference payable upon a sale of the company equal to three times the principal of the loan, or $4,044,450. This preference is senior to the preferences of the outstanding preferred stock. While the loan has since been repaid, this liquidation preference remains outstanding as of September 30, 2012.

(16) Initial investment was made during 2012.

(17) OHSO Clean, Inc. also does business as CleanWell Company.

(18) A portion of this security is held in connection with written call option contracts: 50,000 shares have been pledged to brokers.

(19)

A portion of this security is held in connection with written call option contracts: 1,386,600 shares have been pledged to brokers.

(20) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is $51,924,083. The gross unrealized appreciation based on the tax cost for these securities is $16,103,134. The gross unrealized depreciation based on the tax cost for these securities is $9,304,632.

(21) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through Parallel Universes, Inc., 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."

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2012

(Unaudited)

(22) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated publicly traded companies is $2,000,000. 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 $685,333.

(23) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is $14,243,460. 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 $7,987,097.

(24) The aggregate cost for federal income tax purposes of our U.S. government securities is $9,999,914. The gross unrealized appreciation on the tax cost for these securities is $86. The gross unrealized depreciation on the tax cost of these securities is $0.

(25) The call options with expiration dates of October 20, 2012, expired, and we retained the shares originally covered by these contracts.

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3)(4)(5)(6) – 38.8% of net assets at value					
Private Placement Portfolio (Illiquid) – 16.3% of net assets at value					
Bridgelux, Inc. (7)(8)		Energy			
Manufacturing high-power light emitting diodes (LEDs) and arrays					
Series B Convertible Preferred Stock	(M)		$1,000,000	1,861,504	$2,245,039
Series C Convertible Preferred Stock	(M)		1,352,196	2,130,699	2,757,625
Series D Convertible Preferred Stock	(M)		1,371,622	999,999	1,687,433
Series E Convertible Preferred Stock	(M)		730,369	440,334	832,335
Warrants for Series C Convertible Preferred Stock expiring 12/31/14	(I)		168,270	163,900	123,541
Warrants for Series D Convertible Preferred Stock expiring 8/26/14	(I)		88,531	124,999	93,385
Warrants for Series D Convertible Preferred Stock expiring 3/10/15	(I)		40,012	41,666	31,128
Warrants for Series E Convertible Preferred Stock expiring 12/31/17	(I)		108,867	170,823	130,872
Secured Convertible Bridge Note (including interest)	(M)		529,697	$538,945	548,513
Warrant for Common Stock expiring 10/21/18	(I)		18,816	56,564	2,581
			5,408,380		8,452,452
Cambrios Technologies Corporation (7)(9)		Electronics			
Developing nanowire-enabled electronic materials for the display industry					
Series B Convertible Preferred Stock	(M)		1,294,025	1,294,025	720,672
Series C Convertible Preferred Stock	(M)		1,300,000	1,300,000	724,000
Series D Convertible Preferred Stock	(M)		515,756	515,756	870,338
Series D-2 Convertible Preferred Stock	(M)		92,400	92,400	86,625
			3,202,181		2,401,635
Cobalt Technologies, Inc. (7)(9)(10)		Energy			
Developing processes for making bio- butanol through biomass fermentation					
Series C-1 Convertible Preferred Stock	(M)		749,998	352,112	216,651

Series D-1 Convertible Preferred Stock	(M)		122,070	48,828	33,937
			872,068		250,588
Ensemble Therapeutics Corporation (7)(9)(11)		Healthcare			
Developing DNA- Programmed Chemistry™ for the discovery of new classes of therapeutics					
Series B Convertible Preferred Stock	(M)		2,000,000	1,449,275	0
Secured Convertible Bridge Notes (including interest)	(M)		373,439	$299,169	1,298,436
			2,373,439		1,298,436

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3)(4)(5)(6) – 38.8% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) – 16.3% of net assets at value (Cont.)					
GEO Semiconductor Inc.		Electronics			
Developing programmable, high-performance video and geometry processing solutions					
Participation Agreement with Montage Capital relating to the following assets:					
Senior secured debt, 13.75%, maturing on 6/30/12	(I)		$403,732	$500,000	$476,700
Warrants for Series A Pref. Stock expiring on 9/17/17	(I)		66,684	100,000	61,814
Warrants for Series A-1 Pref. Stock expiring on 6/30/18	(I)		23,566	34,500	21,686
Loan and Security Agreement with GEO Semiconductor relating to the following assets:					
Subordinated secured debt, 15.75%, maturing on 1/1/12	(I)		109,942	$125,000	121,880
Warrants for Series A Pref. Stock expiring on 3/1/18	(I)		7,512	10,000	5,819
Warrants for Series A-1 Pref. Stock expiring on 6/29/18	(I)		7,546	10,000	5,836
			618,982		693,735
Molecular Imprints, Inc. (7)(12)		Electronics			
Manufacturing nanoimprint lithography capital equipment					
Series B Convertible Preferred Stock	(M)		2,000,000	1,333,333	1,789,108
Series C Convertible Preferred Stock	(M)		2,406,595	1,285,071	2,138,498
Non-Convertible Bridge Note	(I)		0	0	3,033,338
			4,406,595		6,960,944
Nanosys, Inc. (7)(13)		Energy			
Developing inorganic nanowires and quantum dots for use in batteries and LED-backlit devices					
Series C Convertible Preferred Stock	(M)		1,500,000	803,428	255,503
Series D Convertible Preferred Stock	(M)		3,000,003	1,016,950	698,410
Series E Convertible Preferred Stock	(M)		496,573	433,688	496,573
			4,996,576		1,450,486

NanoTerra, Inc. (9)(14)		Energy			
Developing surface chemistry and nano- manufacturing solutions					
Senior secured debt, 12.0%, maturing on 2/22/14	(I)		329,307	$378,564	342,650
Senior secured debt, 12.0%, maturing on 2/22/13	(I)		133,121	$153,032	144,855
Warrants for Series A-2 Pref. Stock expiring on 2/22/21	(I)		69,168	446,248	67,659
			531,596		555,164

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3)(4)(5)(6) – 38.8% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) – 16.3% of net assets at value (Cont.)					
Nantero, Inc. (7)(9)(13)		Electronics			
Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes					
Series A Convertible Preferred Stock	(M)		$489,999	345,070	$746,548
Series B Convertible Preferred Stock	(M)		323,000	207,051	451,499
Series C Convertible Preferred Stock	(M)		571,329	188,315	486,760
			1,384,328		1,684,807
Total Unaffiliated Private Placement Portfolio (cost: $23,794,145)					$23,748,247
Rights to Milestone Payments (Illiquid) – 2.3% of net assets at value					
Amgen, Inc. (7)(13)		Healthcare			
Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	(I)		$3,291,750	$3,291,750	$3,362,791
Total Unaffiliated Rights to Milestone Payments (cost: $3,291,750)					$3,362,791
Publicly Traded Portfolio – 20.2% of net assets at value					
NeoPhotonics Corporation (13)		Electronics			
Developing and manufacturing optical devices and components					
Common Stock	(M)		$7,299,590	450,907	$2,065,154

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Solazyme, Inc. (13)(15)(16)		Energy			
Developing algal biodiesel, industrial chemicals and specialty ingredients using synthetic biology					
Common Stock	(M)		$5,444,197	2,304,149	$27,419,373
Total Unaffiliated Publicly Traded Portfolio (cost: $12,743,787)					$29,484,527
Total Investments in Unaffiliated Companies (cost: $39,829,682)					$56,595,565

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3)(17)(18) – 34.1% of net assets at value					
Private Placement Portfolio (Illiquid) – 32.7% of net assets at value					
ABSMaterials, Inc. (7)(9)(13)		Energy			
Developing nano-structured absorbent materials for environmental remediation					
Series A Convertible Preferred Stock	(M)		$435,000	390,000	$1,560,000
Adesto Technologies Corporation (7)(9)		Electronics			
Developing low-power, high- performance memory devices					
Series A Convertible Preferred Stock	(M)		2,200,000	6,547,619	3,328,635
Series B Convertible Preferred Stock	(M)		2,200,000	5,952,381	3,076,031
Series C Convertible Preferred Stock	(M)		1,485,531	2,122,187	1,271,982
			5,885,531		7,676,648
Contour Energy Systems, Inc. (7)(9)(13)		Energy			
Developing batteries using nanostructured materials					
Series A Convertible Preferred Stock	(M)		2,009,995	2,565,798	2,520,935
Series B Convertible Preferred Stock	(M)		1,300,000	812,500	1,348,249
Series C Convertible Preferred Stock	(M)		720,000	688,995	767,076
			4,029,995		4,636,260
D-Wave Systems, Inc. (7)(9)(19)		Electronics			
Developing high- performance quantum computing systems					
Series B Convertible Preferred Stock	(M)		1,002,074	1,144,869	1,311,562
Series C Convertible Preferred Stock	(M)		487,804	450,450	516,036
Series D Convertible Preferred Stock	(M)		1,484,492	1,533,395	1,756,657
Series E Convertible Preferred Stock	(M)		248,049	269,280	308,487
Series F Convertible Preferred Stock	(M)		238,323	258,721	296,391
Warrants for Common Stock expiring 6/30/15	(I)		98,644	153,890	64,272
Secured Convertible Bridge Note (including interest)	(M)		341,047	$337,579	332,058
			3,900,433		4,585,463

Enumeral Biomedical Corp. (7)(9)		Healthcare			
Developing therapeutics and diagnostics through functional assaying of single cells					
Series A Convertible Preferred Stock	(M)		1,026,832	957,038	1,110,164

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3)(17)(18) – 34.1% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) – 32.7% of net assets at value (Cont.)					
HzO, Inc. (7)(9)(13)(14)		Electronics			
Developing novel industrial coatings that protect electronics against damage from liquids					
Series A Convertible Preferred Stock	(M)		$666,667	4,057,294	$1,130,362
Series B Convertible Preferred Stock	(M)		1,000,000	3,947,888	1,099,882
			1,666,667		2,230,244
Kovio, Inc. (7)(9)(13)		Electronics			
Developing semiconductor products using printed electronics and thin-film technologies					
Series A' Convertible Preferred Stock	(M)		5,242,993	2,160,000	1,437,286
Series B' Convertible Preferred Stock	(M)		1,418,540	2,131,827	1,418,539
			6,661,533		2,855,825
Mersana Therapeutics, Inc. (7)(9)		Healthcare			
Developing treatments for cancer based on novel drug delivery polymers					
Series A Convertible Preferred Stock	(M)		700,000	68,451	0
Series B Convertible Preferred Stock	(M)		1,542,098	866,500	0
Unsecured Convertible Bridge Notes (including interest)	(M)		1,442,871	$1,195,875	1,442,871
			3,684,969		1,442,871
Metabolon, Inc. (7)(13)		Healthcare			
Developing service and diagnostic products through the use of a metabolomics, or biochemical, profiling platform					
Series B Convertible Preferred Stock	(M)		2,500,000	371,739	1,951,723
Series B-1 Convertible Preferred Stock	(M)		706,214	148,696	780,689
Series C Convertible Preferred Stock	(M)		1,000,000	1,000,000	1,794,510
Series D Convertible Preferred Stock	(M)		1,499,999	835,882	1,499,999
Warrants for Series B-1 Convertible Preferred Stock expiring 3/25/15	(I)		293,786	74,348	71,142
			5,999,999		6,098,063

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3)(17)(18) – 34.1% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) – 32.7% of net assets at value (Cont.)					
Nextreme Thermal Solutions, Inc. (7)(9)(13)		Energy			
Developing thin-film thermoelectric devices for cooling and energy conversion					
Series A Convertible Preferred Stock	(M)		$4,384,762	44,053	$0
Produced Water Absorbents, Inc. (7)(9)(13)(14)		Energy			
Developing nano-structured absorbent materials for environmental remediation of contaminated water in the oil and gas industries					
Series A Convertible Preferred Stock	(M)		1,000,000	1,000,000	1,000,000
Senova Systems, Inc. (7)(9)(13)(14)		Healthcare			
Developing next-generation sensors to measure pH					
Series B Convertible Preferred Stock	(M)		692,308	692,308	692,308
SiOnyx, Inc. (7)(9)(13)		Electronics			
Developing silicon-based optoelectronic products enabled by its proprietary Black Silicon					
Series A Convertible Preferred Stock	(M)		750,000	233,499	160,367
Series A-1 Convertible Preferred Stock	(M)		890,000	2,966,667	2,037,507
Series A-2 Convertible Preferred Stock	(M)		2,445,000	4,207,537	2,889,736
Series B-1 Convertible Preferred Stock	(M)		1,169,561	1,892,836	1,300,000
Warrants for Series B-1 Convertible Preferred Stock expiring 2/23/17	(I)		130,439	247,350	132,552
			5,385,000		6,520,162
Ultora, Inc. (7)(9)(13)		Energy			
Developing energy-storage devices enabled by carbon nanotubes					
Series A Convertible Preferred Stock	(M)		215,000	215,000	215,000

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3)(17)(18) – 34.1% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) – 32.7% of net assets at value (Cont.)					
Xradia, Inc. (7)(13)		Electronics			
Designing, manufacturing and selling ultra- high resolution 3D x-ray microscopes and fluorescence imaging systems					
Series D Convertible Preferred Stock	(M)		$4,000,000	3,121,099	$6,978,777
Total Non-Controlled Private Placement Portfolio (cost: $48,968,029)					$47,601,785
Publicly Traded Portfolio (Illiquid) – 1.4% of net assets at value					
Champions Oncology, Inc. (13)(14)(20)		Healthcare			
Developing its TumorGraft™ platform for personalized medicine and drug development					
Common Stock	(M)		$2,000,000	2,666,667	$1,973,334
Total Non-Controlled Affiliated Publicly Traded Portfolio (cost: $2,000,000)					$1,973,334
Total Investments in Non-Controlled Affiliated Companies (cost: $50,968,029)					$49,575,119

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Industry (2)	Cost	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (3)(21) – 4.7% of net assets at value					
Private Placement Portfolio (Illiquid) – 4.7% of net assets at value					
Ancora Pharmaceuticals Inc. (7)(9) Developing synthetic carbohydrates for pharmaceutical applications		Healthcare			
Common Stock	(M)		$2,729,817	57,463	$0
Series A Convertible Preferred Stock	(M)		3,855,627	3,855,627	3,855,627
Senior Secured Debt, 12.00%, maturing on 12/11/12	(I)		452,060	$500,000	455,190
			7,037,504		4,310,817
Laser Light Engines, Inc. (7)(9) Manufacturing solid-state light sources for digital cinema and large-venue projection displays		Energy			
Series A Convertible Preferred Stock	(M)		2,000,000	7,499,062	0
Series B Convertible Preferred Stock	(M)		3,095,802	13,571,848	2,181,119
Secured Convertible Bridge Note (including interest)	(M)		385,630	$378,261	385,630
			5,481,432		2,566,749
Total Controlled Private Placement Portfolio (cost: $12,518,936)					$6,877,566
Total Investments in Controlled Affiliated Companies (cost: $12,518,936)					$6,877,566
Total Private Placement and Publicly Traded Portfolio (cost: $103,316,647)					$113,048,250
Total Investments (cost: $103,316,647)					$113,048,250

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

	Method of Valuation (1)	Number of Contracts	Value
Written Call Options (15) – (0.1)% of net assets at value			
Solazyme, Inc. — Strike Price $15.00, 3/17/12	(M)	3,000	$(195,000)
Total Written Call Options (Premiums Received $315,000)			$(195,000)

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

Notes to Consolidated Schedule of Investments

(1) See "Footnote to Consolidated Schedule of Investments" on page 33 for a description of the "Valuation Procedures."

(2) We classify "Energy" 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" companies as those that use nanotechnology to address problems in electronics-related industries, including semiconductors. We classify "Healthcare" 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 "Energy," "Electronics" and "Healthcare." We do not have any portfolio companies classified as "Other" as of December 31, 2011. In the first quarter of 2011, we renamed the sector classification "Electronics/Semiconductors" to "Electronics" and reclassified three companies, NeoPhotonics Corporation, Polatis, Inc., and Xradia, Inc., from a sector classification of "Other" to "Electronics" to reflect a broader definition of electronics to include photonics, metrology, and test and measurement. We also renamed the sector classification "Healthcare/Biotech" to "Healthcare." In the fourth quarter of 2011, we renamed the sector classification, "Cleantech" to "Energy."

(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 $23,794,145. The gross unrealized appreciation based on the tax cost for these securities is $5,997,220. The gross unrealized depreciation based on the tax cost for these securities is $6,043,118.

(5) The aggregate cost for federal income tax purposes of investments in unaffiliated rights to milestone payments is $3,291,750. The gross unrealized appreciation based on the tax cost for these securities is $71,041. The gross unrealized depreciation based on the tax cost for these securities is $0.

(6) The aggregate cost for federal income tax purposes of investments in unaffiliated publicly traded companies is $12,743,787. The gross unrealized appreciation based on the tax cost for these securities is $21,975,176. The gross unrealized depreciation based on the tax cost for these securities is $5,234,436.

(7) We are subject to legal restrictions on the sale of our investment(s) in this company.

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

(8) With our investment in the Series E round of financing, we received a warrant to purchase shares of common stock of up to 30 percent of the amount invested in the Series E round of financing of Bridgelux, Inc., depending on certain financial performance metrics of the company as of December 31, 2011, at a price per share of $1.9056. The number of shares able to be purchased and beginning of the period for when this warrant is exercisable will be set upon receipt of the audited financial statements of the company for the 2011 fiscal year or upon the completion of an IPO or sale of the company, whichever comes first. Bridgelux did not complete an IPO or sale of the company as of December 31, 2011. Also as of that date, the audited financials for the company's 2011 fiscal year were not available. This warrant is, therefore, a contingent asset as of December 31, 2011. With our investment in the bridge note financing in the fourth quarter of 2011, we received a warrant for the purchase of common stock that is exercisable at the date of issuance, but the number of shares for which it can be exercised increases monthly from the date of issuance through the close of the next round of equity financing of the company up to 50 percent of the principal amount invested in the note divided by $1.9056. The warrant for common stock is exercisable for 56,564 shares of common stock of Bridgelux as of December 31, 2011.

(9) 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.

(10) Cobalt Technologies, Inc., also does business as Cobalt Biofuels.

(11) With our investment in a convertible bridge note issued by Ensemble Therapeutics Corporation, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of Ensemble Therapeutics Corporation equal to $149,539.57 divided by the price per share of the class of stock sold in the next financing of Ensemble Therapeutics Corporation. The ability to exercise this warrant is, therefore, contingent on Ensemble Therapeutics Corporation 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.

(12) As part of a loan the Company made to Molecular Imprints in the second quarter of 2011, we received a liquidation preference payable upon a sale of the company equal to three times the principal of the loan, or $4,044,450. This preference is senior to the preferences of the outstanding preferred stock. While the loan has since been repaid, this liquidation preference remains outstanding as of December 31, 2011.

(13) 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.

(14) Initial investment was made during 2011.

(15) A portion of this security is held in connection with written call option contracts: 300,000 shares have been pledged to brokers.

(16) The lock-up period on our 2,304,149 shares of Solazyme, Inc., expired on November 25, 2011.

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

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2011

(17) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is $48,968,029. The gross unrealized appreciation based on the tax cost for these securities is $9,066,325. The gross unrealized depreciation based on the tax cost for these securities is $10,432,569.

(18) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated publicly traded companies is $2,000,000. 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 $26,666.

(19) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through Parallel Universes, Inc., a Delaware company. Our investment is denominated in Canadian dollars and is subject to foreign currency translation. See "Note 2. Summary of Significant Accounting Policies."

(20) Our 2,666,667 shares of Champions Oncology, Inc., became freely tradable on October 1, 2011, pursuant to Rule 144.

(21) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is $12,518,936. 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 $5,641,370.

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

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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. 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 also 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. An independent valuation firm also reviews select portfolio company valuations. The independent valuation firm does not provide proposed valuations.

The fair 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).

- <u>Income Approach (I):</u> 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:

- *<u>Level 1</u>* - inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;

- *<u>Level 2</u>* - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 2 inputs are in those markets for which there are few transactions, the prices are not current, little public information exists or instances where prices vary substantially over time or among brokered market makers; and

- *<u>Level 3</u>* - inputs to the valuation methodology are unobservable and significant to the fair value measurement. Unobservable inputs are those inputs that reflect our own assumptions that market participants would use to price the asset or liability based upon the best available information.

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 options or warrants, are 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.

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C. SHORT-TERM FIXED-INCOME SECURITIES

Short-term fixed-income securities are valued 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:

- The cost of the Company's investment;
- 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 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

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.

H&H Ventures Management, Inc.^{SM} ("Ventures"), formerly Harris & Harris Enterprises, Inc., is a 100 percent wholly owned subsidiary of the Company. Ventures is taxed under Subchapter C of the Internal Revenue Code of 1986 (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 Ventures (sole general partner) and the Company (sole limited partner). Ventures pays taxes on any non-passive investment income generated by Harris Partners I, L.P. For the period ended September 30, 2012, there was no non-passive investment income generated by Harris Partners I, L.P. Ventures, as the sole general partner, consolidates Harris Partners I, L.P. The Company consolidates its wholly owned subsidiary, Ventures, 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 fair statement 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 statement 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, 2011.

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. In accordance with GAAP and Regulation S-X, the Company may only consolidate its interests in investment company subsidiaries and controlled operating companies whose business consists of providing services to the Company. Our wholly owned subsidiary, Ventures, is a controlled operating company that provides services to us and is, therefore, consolidated. 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.

Revision of Previously Reported Consolidated Financial Statements During the First Quarter of 2012. During the period ended March 31, 2012, the Company concluded the Consolidated Statements of Cash Flows erroneously classified cash flow items within operating and investing activities. Specifically, the Company's purchases and sales of various debt, equity and other securities were previously classified within investing activities when such purchases and sales activities should have been classified within operating activities. Following is a list of purchases and sales activities that have now been included in operating activities, rather than investing activities, in the Consolidated Statements of Cash Flows:

Purchase of U.S. government securities
Sale of U.S. government securities
Investment in affiliated portfolio companies
Investment in unaffiliated portfolio companies
Proceeds from sale of investments
Proceeds from call option premiums
Payments for call option purchases
Principal payments received on debt investments

The net impact of these revisions was to increase the total cash used in operating activities and decrease the total cash used in investing activities by $4,475,222, $3,765,559 and $23,780,399 for the three months ended March 31, 2011, the six months ended June 30, 2011, and the nine months ended September 30, 2011, respectively. For the years ended December 31, 2011, and 2010, the net impact was to increase total operating activities and decrease total investing activities by $35,665,311 and $8,058,322, respectively. For the year ended December 31, 2009, the net impact was to decrease total operating activities and increase total investing activities by $15,432,513. The Company assessed the impact of the error on its prior period financial statements and concluded that the error was not material to any of those financial statements.

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.

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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.") As of September 30, 2012, our financial statements include privately held investments and one illiquid publicly traded venture capital investment, Champions Oncology, Inc., collectively fair valued at $98,973,856. The fair values of our privately held and illiquid publicly traded 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.

Cash. Cash includes demand deposits. Cash is carried at cost, which approximates fair value.

Restricted Funds. At September 30, 2012, and December 31, 2011, we held $2,010,010 and $1,512,031, respectively, in "Restricted funds." At September 30, 2012, and December 31, 2011, we held $2,000,000 and $1,500,000, respectively, in a collateral account for our credit facility discussed in "Note 5. Debt." At September 30, 2012, and December 31, 2011, we also held $10,010 and $12,031, respectively, in security deposits for sublessors.

Unaffiliated Rights to Milestone Payments. At September 30, 2012, the outstanding milestone payments from Amgen, Inc.'s acquisition of Biovex Group, Inc., were valued at $3,400,488. The milestone payments are derivatives and valued using the probability-adjusted, present value of proceeds from future payments that would be due upon successful completion of certain regulatory and sales milestones. If all remaining milestones are met, we would receive $9,526,393. There can be no assurances as to how much of this amount we will ultimately realize or when it will be realized, if at all.

Funds Held in Escrow from Sales of Investments. At September 30, 2012, there were funds held in escrow fair valued at $588,276 relating to the sales of Innovalight, Inc., and Crystal IS, Inc. Funds held in escrow are valued using certain discounts applied to the amounts withheld. Funds held in escrow from the Innovalight transaction will be released in January 2013 upon settlement of any indemnity claims and expenses related to the transaction. A portion of the funds held in escrow from the Crystal IS transaction was released on April 30, 2012. The balance of the Crystal IS funds in escrow will be released in March 2013 upon settlement of any remaining indemnity claims and expenses related to the transaction. If the funds held in escrow for these transactions are released in full, we would receive $1,201,074. On March 16, 2012, the Company received payment of its portion of the proceeds held in escrow since the closing of the transaction on March 4, 2011, from Amgen, Inc.'s acquisition of BioVex Group, Inc., totaling $953,480.

Prepaid Expenses. We include prepaid insurance premiums and deferred financing charges in "Prepaid expenses." Prepaid insurance premiums are recognized over the term of the insurance contract. Deferred financing charges consist of fees and expenses paid in connection with the closing of credit facilities and are capitalized at the time of payment. Deferred financing charges are amortized over the term of the credit facility discussed in "Note 5. Debt." Amortization of the financing charges is included in "Interest and other debt expense" in the "Consolidated Statements of Operations."

Property and Equipment. Property and equipment are included in "Other assets" and are carried at $302,688 and $331,006 at September 30, 2012, and December 31, 2011, 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.

Post Retirement Plan Liabilities. The Company provides a Retiree Medical Benefit Plan for employees who meet certain eligibility requirements. Until it was terminated on May 5, 2011, the Company also provided an Executive Mandatory Retirement Benefit Plan for certain individuals employed by us in a bona fide executive or high policy-making position. The net periodic postretirement benefit cost for the year is determined as the sum of service cost for the year, interest on the accumulated postretirement benefit obligation and amortization of the transition obligation (asset) less previously accrued expenses over the average remaining service period of employees expected to receive plan benefits. 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 are recognized as a component of net assets.

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. Securities are deemed to be non-income producing if, on their last interest or dividend date, no cash was paid or no cash or in-kind dividends were declared. These write-offs are recorded as a debit to interest income. During the three months and nine months ended September 30, 2012, the Company earned $74,821 and $210,146, respectively, in interest on U.S. government securities, senior secured debt, participation agreements, subordinated secured debt and interest-bearing accounts. During the three months and nine months ended September 30, 2012, the Company recorded, on a net basis, $275,148 and $190,466, respectively, of bridge note interest. The nine months total includes a partial write-off of previously accrued bridge note interest of $200,583, which was recognized in the second quarter of 2012, offset by $236,238 of interest recognized in the third quarter upon conversion of this investment.

Loan Fees. Loan fees received in connection with our venture debt investments are deferred. The unearned fee income is accreted into income based on the effective interest method over the life of the investment.

Call Options. The Company writes covered call options on publicly traded securities with the intention of earning option premiums. Option premiums may increase the Company’s realized gains and, therefore, may help increase distributable income, but may limit the realized gains on the security. When a Company writes (sells) an option, an amount equal to the premium received by the Company is recorded in the Consolidated Statements of Assets and Liabilities as a liability. The amount of the liability is subsequently marked-to-market to reflect the current market value of the option written. When an option expires, the Company realizes a gain on the option to the extent of the premiums received. Premiums received from writing options that are exercised or closed are added to or offset against the proceeds or amount paid on the transaction to determine the realized gain or loss.

Stock-Based Compensation. The Company has a stock-based employee compensation plan. The Company accounts for the Amended and Restated Harris & Harris Group, Inc. 2012 Equity Incentive Plan (the "Amended 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 restricted stock awards, 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, 2012, and December 31, 2011, the increase to our operating expenses was offset by the increase to our additional paid-in capital, resulting in no net impact to our net asset value. Additionally, the Company does not record the potential tax benefits associated with the expensing of stock options because the Company currently intends to qualify as a regulated investment company ("RIC") under Subchapter M of the Code, and the deduction attributable to such expensing, therefore, is unlikely to provide any additional tax savings. 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 stock-based awards 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 8. Stock-Based Compensation" for further discussion.

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, escalations and landlord payments on a straight-line basis in the determination of rent expense over the lease term.

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.

Income Taxes. As we intend to qualify as a RIC under Subchapter M of the Code, the Company does not provide for income taxes. The Company has capital loss carryforwards that can be used to offset net realized capital gains. 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, Ventures, which is a C Corporation. See "Note 9. Income Taxes."

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, 2012, included in the net increase in unrealized appreciation on investments was unrealized appreciation of $199,932 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).

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

NOTE 4. BUSINESS RISKS AND UNCERTAINTIES

We invest primarily in privately held companies, the securities of which are inherently illiquid. We also have investments in small publicly traded companies. 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 not have attained profitability, and many of these businesses also lack management depth and have limited or no history of operations. Because of the speculative nature of our investments and the lack of a liquid market for and restrictions on transfers of privately held investments and some of our publicly traded 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 microeconomic events affecting a single sector, industry or portfolio company and to general macroeconomic events that may be unrelated to our portfolio companies. These factors may subject the value of our portfolio to greater volatility than a company that follows a diversification strategy. As of September 30, 2012, our largest 10 investments by value accounted for approximately 73 percent of the value of our equity-focused venture capital portfolio. Our largest two investments, by value, Solazyme, Inc., a publicly traded company, and Adesto Technologies Corporation, a privately held company, accounted for approximately 18.8 percent and 12.9 percent, respectively, of our equity-focused venture capital portfolio at September 30, 2012.

Approximately 78 percent of our equity-focused venture capital portfolio by value was comprised of securities of 25 privately held companies. 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 securities 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 the securities in our portfolio may differ significantly from the values that would be placed on these securities if a ready market for the securities existed. Any changes in valuation are recorded in our Consolidated Statements of Operations as "Net increase in unrealized appreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

NOTE 5. DEBT

On February 24, 2011, the Company established a $10 million three-year revolving credit facility (the “credit facility”) with TD Bank, N.A. to be used in conjunction with its investments in venture debt.

The credit facility matures on February 24, 2014, and generally bears interest, at the Company's option, based on (i) LIBOR plus 1.25 percent or (2) the higher of the federal funds rate plus fifty basis points (0.50 percent) or the U.S. prime rate as published in the Wall Street Journal. The credit facility generally requires payment of interest on a monthly basis and requires the payment of a non-use fee of 0.15 percent annually. All outstanding principal is due upon maturity. The credit facility is secured by cash collateral held in a non-interest bearing account at TD Bank. The credit facility contains affirmative and restrictive covenants, including: (a) periodic financial reporting requirements, (b) maintaining our status as a BDC (c) maintaining unencumbered, liquid assets of not less than $7,500,000, (d) limitations on the incurrence of additional indebtedness, (e) limitations on liens, and (f) limitations on mergers and dissolutions. The credit facility is used to supplement our capital to make additional venture debt investments.

The Company's outstanding debt balance was $2,000,000 and $1,500,000, at September 30, 2012, and December 31, 2011, respectively. At September 30, 2012, and December 31, 2011, $2,000,000 and $1,500,000, respectively, was held in a collateral account at T.D. Bank as security for the loan. The weighted average annual interest cost for the nine months ended September 30, 2012, and twelve months ended December 31, 2011, was 1.6 percent and 1.5 percent, respectively, exclusive of amortization of closing fees and other expenses related to establishing the credit facility. The remaining capacity under the credit facility was $8,000,000 at September 30, 2012. At September 30, 2012, the Company was in compliance with all financial covenants required by the credit facility.

NOTE 6. FAIR VALUE OF INVESTMENTS

At September 30, 2012, our financial assets were categorized as follows in the fair value hierarchy:

	Fair Value Measurement at Reporting Date Using:			
Description	September 30, 2012	Unadjusted 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	$10,000,000	$ 10,000,000	$ 0	$ 0
Privately Held Portfolio Companies:				
Preferred Stock	$84,272,454	$ 0	$ 0	$ 84,272,454
Bridge Notes	$4,061,774	$ 0	$ 0	$ 4,061,774
Warrants	$616,083	$ 0	$ 0	$ 616,083
Rights to Milestone Payments	$3,400,488	$ 0	$ 0	$ 3,400,488
Common Stock	$174,540	$ 0	$ 0	$ 174,540
Senior Secured Debt	$778,482	$ 0	$ 0	$ 778,482
Participation Agreements	$1,198,610	$ 0	$ 0	$ 1,198,610
Subordinated Secured Debt	$123,420	$ 0	$ 0	$ 123,420
Non-Convertible Promissory Note	$3,033,338	$ 0	$ 0	$ 3,033,338

Publicly Traded Portfolio Companies:				
Common Stock	$26,217,767	$ 24,903,100	$ 0	$ 1,314,667
Total Investments	$133,876,956	$ 34,903,100	$ 0	$ 98,973,856
Liabilities:				
Written Call Options	$364,080	$ 364,080	$ 0	$ 0
Total	$364,080	$ 364,080	$ 0	$ 0

Significant Unobservable Inputs

The table below presents the valuation technique and quantitative information about the significant unobservable inputs utilized by the Company in the fair value measurements of Level 3 assets. Unobservable inputs are those inputs for which little or no market data exists and, therefore, require an entity to develop its own assumptions.

	Fair Value at Sept. 30, 2012	Valuation Techniques(s)	Unobservable Input	Range	
			Private Offering Price	$0.14 - $6.73	
			Non-Performance Risk	0% - 100%	
			Revenue Multiple	1.3 - 2.7	
			Discount for Lack of Marketability	20	%
Preferred Stock	$ 84,272,454	Market Approach	Probability of Exit Outcomes	0% - 100%	
			Private Offering Price	$1.00	
Bridge Notes	4,061,774	Market Approach	Non-Performance Risk	0	%
			Private Offering Price	$0.54 - $47.51	
Common Stock	174,540	Market Approach	Non-Performance Risk	0% -100%	
			Stock Price	$.09 - $2.36	
		Black-Sholes-Merton	Volatility	107	%
Warrants	616,083	Model	Expected Term	0.50 – 9.50 Years	
		Probability Weighted	Probability of Achieving Independent Milestones	0% - 75%	
Rights to Milestone Payments	3,400,488	Discounted Cash Flow	Probability of Achieving Dependent Milestones	0.44% - 28.125%	
			Warrant Adjusted Effective Yield	23.1% - 29.9%	
			Effective Yield	23.1% - 37.4%	
			Non-Performance Risk	0% - 25%	
			Participation Payment Risk	0	%
Participation Agreements	1,198,610	Income Approach	Discount for Comparable Prices of High-Yield Debt	0	%
			Warrant Adjusted Effective Yield	33.1	%
			Effective Yield	41.4	%
Subordinated Secured Debt	123,420	Income Approach	Non-Performance Risk	25	%
			Effective Yield	15.7	%
Senior Secured Debt	778,482	Income Approach	Non-Performance Risk	0	%
			Probability of Exit Outcomes	25% - 75%	
			Private Offering Price	$1.50	

Non-Convertible Promissory Note	3,033,338	Income Approach	Non-Performance Risk	50	%
OTC Traded Common Stock	$1,314,667	Market Approach	Non-Performance Risk	25	%
			Volume Weighted Average Price per Share	$0.63 - $0.81	
Total	$98,973,856				

<u>Valuation Methodologies and Inputs for Level 3 Assets</u>

The following sections describe the valuation techniques and significant unobservable inputs used to measure Level 3 assets.

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Preferred Stock, Bridge Notes and Common Stock

Preferred stock, bridge notes and common stock are valued by a market approach using internal models with inputs, most of which are not market observable. Common inputs for valuing Level 3 preferred stock, bridge note and private common stock investments include: prices from recently executed private transactions in a company's securities or unconditional firm offers, revenue multiples of comparable publicly traded companies, discounts for lack of marketability, rights and preferences of the class of securities we own as compared with other classes of securities the portfolio company has issued, particularly related to potential liquidity scenarios of an IPO or an acquisition transaction, and management's best estimate of risk attributable to non-performance risk. We define non-performance as the risk that the price per share (or implied valuation of a portfolio company) or the effective yield of a debt security of a portfolio company, as applicable, does not appropriately represent the risk that a portfolio company with negative cash flow 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 of the last round of financing. The assessment of non-performance risk typically includes an evaluation of the financial condition and operating results of the company, the company's progress towards milestones, and the long-term potential of the business and technology of the company and how this potential may or may not affect the value of the shares owned by us. An increase to the non-performance risk or a decrease in the private offering price of a future round of financing from that of the most recent round would result in a lower fair value measurement and/or a change in the distribution of value among the classes of securities we own.

Bridge notes commonly contain terms that provide for the conversion of the full amount of principal, and sometimes interest, into shares of preferred stock at a defined price per share and/or the price per share of the next round of financing. The use of a discount for non-performance risk in the valuation of bridge notes would indicate the potential for conversion of only a portion of the principal, plus interest when applicable, into shares of preferred stock or the potential that a conversion event will not occur and that the likely outcome of a liquidation of assets would result in payment of less than the remaining principal outstanding of the note. An increase in non-performance risk would result in a lower fair value measurement.

Warrants

We use the Black-Scholes-Merton option-pricing model to determine the fair value of warrants held in our portfolio. Option pricing models, including the Black-Scholes-Merton model, require the use of subjective input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. In the Black-Scholes-Merton model, variations in the expected volatility or expected term assumptions have a significant impact on fair value. Because the securities underlying the warrants in our portfolio are not publicly traded, many of the required input assumptions are more difficult to estimate than they would be if a public market for the underlying securities existed.

An input to the Black-Scholes-Merton option-pricing model is the value per share of the type of stock for which the warrant is exercisable as of the date of valuation. This input is derived according to the methodologies discussed in “Preferred Stock, Bridge Notes and Common Stock.”

Rights to Milestone Payments

Rights to Milestone Payments are valued using a probability-weighted discounted cash flow model. As part of Amgen Inc.’s acquisition of our former portfolio company, BioVex Group, Inc., we are entitled to potential future milestone payments based upon the achievement of certain regulatory and sales milestones. We assign probabilities to the achievements of the various milestones. Milestones identified as independent milestones can be achieved irrespective of the achievement of other contractual milestones. Dependent milestones are those that can only be achieved after another, or series of other, milestones are achieved. The interest rates used in these models are observable inputs from sources such as the Federal Reserve published interest rates.

Participation Agreements, Subordinated Secured Debt and Senior Secured Debt

We invest in venture debt investments through participation agreements, subordinated secured debt and senior secured debt. We value these securities using an income approach. 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. Common inputs for valuing Level 3 debt investments include: the effective yield of the debt investment or, in the case where we have received warrant coverage, the warrant-adjusted effective yield of the security, adjustments for changes in the yields of comparable publicly traded high-yield debt funds and risk-free interest rates and an assessment of non-performance risk. For those debt investments made through participation agreements, we include discounts for the risk of breach of the participation agreements. For venture debt investments, an increase in yields would result in a lower fair value measurement. Furthermore, yields would decrease, and value would increase, if the company is exceeding targets and risk has been substantially reduced from the level of risk that existed at the time of investment. Yields would increase, and values would decrease, if the company is failing to meet its targets and risk has been increased from the level of risk that existed at the time of investment.

Non-Convertible Promissory Note

We have one non-convertible promissory note, which we value using an income approach that uses a valuation technique to convert future amounts to a single present value. This security has a liquidation preference payable upon a sale of the company equal to three times the principal of the loan. While the loan has since been repaid, this liquidation preference remains outstanding as of September 30, 2012. Inputs include the preferred stock price of the portfolio company, an assessment of non-performance risk, the probability of exit outcomes between an IPO and an acquisition and the resulting impact on rights and preferences of the class of securities we own as compared with other classes of securities the portfolio company has issued.

OTC Traded Common Stock

Common stock that is thinly traded in OTC markets is valued using internal models with inputs that are not market observable. Common inputs for stock include the volume-weighted average of recent prices per share of privately negotiated financing transactions and the volume-weighted price per share of the stock over a period of time and an assessment of non-performance risk.

The following table shows the components of change in the financial assets categorized as Level 3 for the three months ended September 30, 2012.

	Beginning Balance 7/1/2012	**Total Realized Gains (Losses) Included in Changes in Net Assets**	Transfers	**Total Unrealized Appreciation (Depreciation) Included in Changes in Net Assets**	**Investments in Portfolio Companies, Interest on Bridge Notes, and Amortization of Loan Fees, Net**	**Disposals**	**Ending Balance 9/30/2012**	**Amount of Total Appreciation (Depreciation) for t Period Included in Changes in Net Ass Attributable to the Change in Unrealiz Gains or Losses Re to Assets Still Held Reporting Date**
Preferred Stock	$79,123,640	$0	$0	$2,108,893	$3,039,921	$0	$84,272,454	$2,108,893
Bridge Notes	3,474,341	0	(1,633,296)	1,542,398	678,331	0	4,061,774	1,542,398
Common Stock	0	0	1,633,296	(1,458,756)	0	0	174,540	(1,458,756)
Warrants	701,310	0	0	(216,765)	131,538	0	616,083	(216,765)
Rights to Milestone Payments	3,386,224	0	0	14,264	0	0	3,400,488	14,264
Participation Agreements	1,214,935	0	0	37,027	(222)	(53,130)	1,198,610	37,027
Subordinated Secured Debt	119,760	0	0	4,703	(1,043)	0	123,420	4,703
Senior Secured Debt	843,180	0	0	(3,562)	13,036	(74,172)	778,482	(3,562)
Non-Convertible Promissory Note	3,033,338	0	0	0	0	0	3,033,338	0
OTC Traded Common Stock	1,973,334	0	0	(658,667)	0	0	1,314,667	(658,667)
Total	$93,870,062	$0	$0	$1,369,535	$3,861,561	$(127,302)	$98,973,856	$1,369,535

There were no transfers in or out of Level 3 during the three months ended September 30, 2012.

The following table shows the components of change in the financial assets categorized as Level 3 for the nine months ended September 30, 2012.

	Beginning Balance 1/1/2012	**Total Realized Gains (Losses) Included in Changes in Net Assets**	Transfers	**Total Unrealized Appreciation (Depreciation) Included in Changes in Net Assets**	**Investments in Portfolio Companies, Interest on Bridge Notes, and Amortization of Loan Fees, Net**	Disposals	**Ending Balance 9/30/2012**	**Amount of Total Appreciation (Depreciation) for Period Included in Changes in Net As Attributable to th Change in Unreal Gains or Losses R to Assets Still Hel Reporting Date**
Preferred Stock	$68,833,189	$0	$905,333	$6,768,873	$7,765,059	$0	$84,272,454	$6,768,873
Bridge Notes	4,007,509	0	(2,538,629)	1,290,647	1,302,247	0	4,061,774	1,290,647
Common Stock	0	0	1,633,296	(1,458,756)	0	0	174,540	(1,458,756)
Warrants	728,787	0	0	(328,449)	215,745	0	616,083	(328,449)
Rights to Milestone Payments	3,362,791	0	0	37,697	0	0	3,400,488	37,697
Participation Agreements	560,200	0	0	39,797	713,842	(115,229)	1,198,610	39,797
Subordinated Secured Debt	121,880	0	0	2,895	(1,355)	0	123,420	2,895
Senior Secured Debt	942,695	0	0	17,248	34,574	(216,035)	778,482	17,248
Non-Convertible Promissory Note	3,033,338	0	0	0	0	0	3,033,338	0
OTC Traded Common Stock	1,973,334	0	0	(658,667)	0	0	1,314,667	(658,667)
Total	$83,563,723	$0	$0	$5,711,285	$10,030,112	$(331,264)	$98,973,856	$5,711,285

There were no transfers in or out of Level 3 during the nine months ended September 30, 2012.

At December 31, 2011, our financial assets were categorized as follows in the fair value hierarchy:

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Fair Value Measurement at Reporting Date Using:

Description	December 31, 2011	Unadjusted 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	$0	$ 0	$ 0	$ 0
Privately Held Portfolio Companies:				
Preferred Stock	$68,833,189	$ 0	$ 0	$ 68,833,189
Bridge Notes	$4,007,509	$ 0	$ 0	$ 4,007,509
Warrants	$728,787	$ 0	$ 0	$ 728,787
Rights to Milestone Payments	$3,362,791	$ 0	$ 0	$ 3,362,791
Senior Secured Debt	$942,695	$ 0	$ 0	$ 942,695
Participation Agreement	$560,200	$ 0	$ 0	$ 560,200
Subordinated Secured Debt	$121,880	$ 0	$ 0	$ 121,880
Non-Convertible Promissory Note	$3,033,338	$ 0	$ 0	$ 3,033,338
Publicly Traded Portfolio Companies:				
Common Stock	$31,457,861	$ 29,484,527	$ 0	$ 1,973,334
Total Investments	$113,048,250	$ 29,484,527	$ 0	$ 83,563,723
Liabilities:				
Written Call Options	$195,000	$ 195,000	$ 0	$ 0
Total	$195,000	$ 195,000	$ 0	$ 0

The following table shows the components of change in the financial assets categorized as Level 3 for the three months ended September 30, 2011.

	Beginning Balance 7/1/2011	**Total Realized (Losses) Gains Included in Changes in Net Assets**	Transfers	**Total Unrealized Appreciation (Depreciation) Included in Changes in Net Assets**	**Investments in Portfolio Companies, Interest on Bridge Notes, and Amortization of Loan Fees, Net**	Disposals	**Ending Balance 9/30/2011**	**Amou Appr (Depr the Pe in Chan Assets to the Unrea Losse Assets**

								the R
Preferred Stock	$67,766,920	$(2,546,173)	$453,474	$(5,046,318)	$5,041,531	$(4,551,668)	$61,117,766	$(7,57
Bridge Notes	5,208,640	34,927	(453,474)	11,383	588,591	(458,569)	4,931,498	47,2
Common Stock	0	(135,105)	0	135,105	0	0	0	0
Warrants	737,400	(37,196)	0	(50,190)	0	0	650,014	(87,3
Rights to Milestone Payments	3,316,581	0	0	27,891	0	0	3,344,472	27,8
Participation Agreement	519,853	0	0	11,368	3,149	0	534,370	11,3
Subordinated Secured Debt	117,150	0	0	3,988	1,692	0	122,830	3,98
Senior Secured Debt	597,310	0	0	12,413	(65,823)	0	543,900	12,4
Non-Convertible Promissory Note	4,381,488	0	0	0	0	(1,348,150)	3,033,338	0
Publicly Traded Common Stock	49,241,940	0	(2,940,405)	(23,548,403)	0	0	22,753,132	(23,5
Total	$131,887,282	$(2,683,547)	$(2,940,405)	$(28,442,763)	$5,569,140	$(6,358,387)	$97,031,320	$(31,1

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The following table shows the components of change in the financial assets categorized as Level 3 for the nine months ended September 30, 2011.

	Beginning Balance 1/1/2011	**Total Realized Gains (Losses) Included in Changes in Net Assets**	Transfers	**Total Unrealized (Depreciation) Appreciation Included in Changes in Net Assets**	**Investments in Portfolio Companies, Interest on Bridge Notes, and Amortization of Loan Fees, Net**	Disposals	**Ending Balance 9/30/2011**	**Ar (D Ap th In Ch As At th Ur Ga or Re As Sti at Re Da**
Preferred Stock	$100,451,746	$4,613,504	$(28,611,520)	$(10,881,553)	$8,467,096	$(12,921,507)	$61,117,766	$(
Bridge Notes	3,565,062	34,927	(1,785,265)	408,592	3,166,751	(458,569)	4,931,498	4
Common Stock	977,414	(2,101,696)	(479,269)	1,767,415	0	(163,864)	0	0
Warrants	684,780	91,536	108,867	(197,117)	121,422	(159,474)	650,014	(
Rights to Milestone Payments	0	0	3,291,750	52,722	0	0	3,344,472	5
Participation Agreement	471,420	0	0	55,502	7,448	0	534,370	5
Subordinated Secured Debt	0	0	0	14,669	108,161	0	122,830	1
Senior Secured Debt	0	0	0	13,654	530,246	0	543,900	1
Non-Convertible Promissory Note	0	0	0	3,033,338	1,348,150	(1,348,150)	3,033,338	3

Publicly Traded Common Stock	0	0	22,675,822	(2,472,690)	2,550,000	0	22,753,132	(
Total	$106,150,422	$2,638,271	$(4,799,615)	$(8,205,468)	$16,299,274	$(15,051,564)	$97,031,320	$(

NOTE 7. DERIVATIVES

The Company has written covered call options on a portion of its holdings of two of its publicly traded portfolio companies in exchange for the receipt of a premium paid in cash upon the writing of the option. The option provides the holder the right, but not the obligation, to purchase the shares on which the option is held at a specified price over a specified future period. The call options were sold at a strike price above the market price on the date of the sale allowing the Company to receive potential appreciation in addition to the premium.

Transactions in options written during the nine months ended September 30, 2012, were as follows:

	Number of Contracts	Premium
Options outstanding at December 31, 2011	3,000	$315,000
Options written	30,669	2,724,113
Options expired	(2,250)	(95,165)
Options terminated in closing transactions	(17,053)	(1,932,535)
Options outstanding at September 30, 2012	14,366	$1,011,413

At September 30, 2012, we had rights to milestone payments from Amgen, Inc.'s acquisition of our former portfolio company, BioVex Group, Inc. These milestone payments were fair valued at $3,400,488 and are contingent upon certain milestones being achieved in the future.

The following tables present the value of derivatives held at September 30, 2012, and the effect of derivatives held during the nine months ended September 30, 2012, along with the respective location in the financial statements.

	Assets		**Liabilities**	
Derivatives	Location	Fair Value	Location	Fair Value
Equity Contracts	—	—	Written call options payable	$364,080
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Investments	$3,400,488	—	—

<u>Statement of Operations</u>

Derivatives	Location	Realized Gain/(Loss)	**Change in unrealized Appreciation / (Depreciation)**
Equity Contracts	Net Realized and Unrealized Gain (Loss)	$ 458,911	$ 527,333
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex	Net Realized and Unrealized Gain (Loss)	$ 0	$ 37,697

Group, Inc.

NOTE 8. STOCK-BASED COMPENSATION

In 2006, the Company established the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan"), which provides for the grant of equity-based awards of stock options to our officers and employees who are selected by our Compensation Committee and our directors for participation in the plan and subject to compliance with the 1940 Act.

On February 29, 2012, the Board of Directors approved the Amended and Restated Harris & Harris Group, Inc. 2012 Equity Incentive Plan (the "Amended Stock Plan"), subject to shareholder approval. The Amended Stock Plan replaces the Stock Plan. In addition to awards already permissible under the Stock Plan, the Amended Stock Plan permits the issuance of restricted stock for up to 10 percent of our issued and outstanding shares. On April 3, 2012, we received an exemptive order from the SEC permitting us to award shares of restricted stock to our officers, employees and directors (the "Exemptive Order"). The Exemptive Order did not permit the issuance of restricted stock until the Amended Stock Plan was approved by our shareholders. On June 7, 2012, the Amended Stock Plan was approved by our shareholders.

A maximum of 20 percent of the total shares of our common stock issued and outstanding currently are available for awards. Under the Amended Stock Plan, no more than 50 percent of the shares of stock reserved for the grant of awards under the Stock Plan may be restricted stock awards at any time during the term of the Amended Stock Plan. No more than 1,000,000 shares of our common stock may be made subject to awards under the Amended Stock Plan to any individual in any year.

Unless terminated earlier by the approval of the shareholders, the Amended Stock Plan will expire on June 7, 2022. The expiration of the Amended Stock Plan will not, by itself, adversely affect the rights of plan participants under awards that are outstanding at the time the Amended Stock Plan expires. Our Board of Directors may terminate, modify or suspend the Amended Stock Plan at any time, provided that no modification of the Amended Stock Plan will be effective unless and until any required shareholder approval has been obtained. The Board of Directors may terminate, modify or amend any outstanding award under the Amended Stock Plan at any time provided that, in such event, the award holder may exercise any vested options prior to such termination of the Amended Stock Plan or award.

Stock Option Awards

During the nine months ended September 30, 2012, and the year ended December 31, 2011, the Compensation Committee of the Board of Directors of the Company did not grant any stock options. On August 3, 2011, the Compensation Committee decided that any future grants of options, if they occur, would not be awarded at a price below net asset value per share. On May 11, 2012, certain executive officers voluntarily cancelled 1,963,745 outstanding stock options for no consideration. Upon cancellation, we recognized $1,365,242 in compensation expense related to these previously granted options. On May 18, 2012, the Company announced that if the Amended Stock Plan was approved by shareholders, the Compensation Committee currently does not plan to grant new stock options to employees.

For the three months and nine months ended September 30, 2012, the Company recognized $41,530 and $1,932,821, respectively, of compensation expense related to stock option awards in the Consolidated Statement of Operations. The nine months total includes $1,365,242 related to the voluntary cancellation of stock options. As of September 30, 2012, there was approximately $264,926 of unrecognized compensation cost related to unvested stock option awards. This cost is expected to be recognized over a weighted-average period of approximately one year. For the three months and nine months ended September 30, 2011, the Company recognized $442,201 and $1,427,321, respectively, of compensation expense in the Consolidated Statements of Operations.

For the three and nine months ended September 30, 2012, no options were exercised. For the three months ended September 30, 2011, no options were exercised. For the nine months ended September 30, 2011, a total of 122,437 options were exercised for total proceeds to the Company of $491,058.

A summary of the changes in outstanding stock options for the nine months ended September 30, 2012, is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Options Outstanding at January 1, 2012	3,389,117	$ 8.13	$ 5.04	4.96	$ 0
Granted	0	$ 0	$ 0	0	
Exercised	0	$ 0	$ 0	0	
Forfeited or Expired	1,963,745	$ 6.94	$ 4.14	4.41	
Options Outstanding at September 30, 2012	1,425,372	$ 9.77	$ 6.27	3.93	$ 86
Options Exercisable at September 30, 2012	1,368,502	$ 9.78	$ 6.25	3.94	$ 86
Options Exercisable and Expected to be Exercisable at September 30, 2012	1,422,870	$ 9.77	$ 6.27	3.93	$ 86

The aggregate intrinsic value in the table above with respect to stock options outstanding, exercisable and expected to be exercisable, is calculated as the difference between the Company's closing stock price of $3.79 on the last trading day of the third quarter of 2012 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 stock options been fully vested and all option holders exercised their awards on September 30, 2012. For the nine months ended September 30, 2012, no stock options were exercised.

Restricted Stock Awards

On June 7, 2012, upon shareholder approval of the Amended Stock Plan, our seven non-employee directors were granted 2,000 shares of restricted stock each that vest over a three-year period. The Exemptive Order provides for a similar grant for the non-employee directors annually.

On June 11, 2012, the Compensation Committee granted employees a total of 1,780,000 shares of restricted stock. A total of 712,000 of these shares vest over a period from December 31, 2012, through June 30, 2017, based on the employees' continued service to the Company ("service-based awards"). The remaining 1,068,000 awards vest when the volume-weighted stock price is at or above pre-determined stock price targets over a 30-day period ("market-based awards"). These pre-determined stock price targets range from $5.00 per share to $9.00 per share. After this initial employee grant, the Compensation Committee does not plan to grant additional restricted stock to existing employees for at least three years.

The compensation expense for the service-based awards is determined by the market price of our stock at the date of grant applied to the total number of shares we anticipate to fully vest. The market prices on the dates of the director and employee service-based awards were $3.55 and $3.38, respectively.

The compensation expense for the market-based awards is determined by the fair value of the awards applied to the number of shares granted, net of estimated forfeitures. The fair values of the market-based awards were determined using a lattice model. The fair values of these awards range from $2.25 per share to $2.92 per share and will be expensed over derived service periods ranging from approximately 37 to 75 months.

For the three months and nine months ended September 30, 2012, we recognized $430,774 and $524,602, respectively, of compensation expense related to restricted stock awards. As of September 30, 2012, there was unrecognized compensation cost of $4,637,971 related to restricted stock awards. This cost is expected to be recognized over a weighted average period of approximately 2.4 years.

Non-vested restricted stock awards as of September 30, 2012, and changes during the nine months ended September 30, 2012, were as follows:

	Shares	Weighted-Average Grant Date Fair Value Per Share	
Outstanding at beginning of year	0	$	0
Granted	1,794,000		2.88
Vested	0		0
Forfeited	0		0
Outstanding at September 30, 2012	1,794,000	$	2.88

<u>NOTE 9. INCOME TAXES</u>

We have elected to be treated as a RIC under 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 to the extent not offset by the capital loss carryforward. We currently intend to retain and designate any net capital gain as “designated undistributed capital gains” under the rules of the Code. 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 98.2 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. Capital gains realized during the nine months ended September 30, 2012, were offset by the capital loss carryforwards at December 31, 2011, and, accordingly, are not subject to corporate income or excise tax.

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 pursuant to Section 851(e) of the Code 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."

We have received SEC certification since 1999, including for 2011, pursuant to Section 851(e) of the Code. We qualified for RIC treatment in 2011 even without certification, but there can be no assurance that we will qualify for or receive certification for 2012 or subsequent years (to the extent we need additional certification) or that we will actually qualify for Subchapter M treatment in subsequent years. 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 three months ended September 30, 2012, and 2011, we had expense of $7,161 and $1,250, respectively, in federal, state and local taxes. For the nine months ended September 30, 2012, and 2011, we had expense of $15,236 and $3,643, respectively, in federal, state and local taxes. At September 30, 2012, and 2011, 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, Ventures, which is taxed as a C Corporation. For the three months ended September 30, 2012, and 2011, our income tax expense for Ventures was $7,161 and $1,250, respectively. For the nine months ended September 30, 2012, and 2011, our income tax expense for Ventures was $14,331 and $2,635, respectively.

NOTE 10. CHANGE IN NET ASSETS PER SHARE

The following table sets forth the computation of basic and diluted per share net increases (decreases) in net assets resulting from operations for the three months and nine months ended September 30, 2012, and September 30, 2011.

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2012	2011	2012	2011
Numerator for (decrease) increase in net assets per share	$(3,669,717)	$(33,084,607)	$4,547	$(12,988,545)

Denominator for basic weighted average shares	31,000,601	31,000,601	31,000,601	30,973,353
Basic net (decrease) increase in net assets per share resulting from operations	$(0.12)	$(1.07)	$0.00	$(0.42)
Denominator for diluted weighted average shares	31,000,601	31,000,601	31,000,681	30,973,353
Diluted net (decrease) increase in net assets per share resulting from operations	$(0.12)	$(1.07)	$0.00	$(0.42)

For the nine months ended September 30, 2012, the calculation of net increase in net assets resulting from operations per diluted share includes 80 stock options because such stock options were dilutive. All other stock options and restricted stock awards may be dilutive in future periods in which there is a net increase in net assets resulting from operations 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 11. COMMITMENTS AND CONTINGENCIES

On December 28, 2011, the Asahi Kasei Group completed its acquisition of Crystal IS, Inc. As of September 30, 2012, approximately $273,000 in proceeds from the transaction is held in escrow to cover potential indemnity claims and the expenses of the stockholder agent. If claims are made related to certain intellectual property and patents included in the transaction that exceed the escrow amounts withheld, additional claims could be made seeking funds from the former stockholders, including the Company. This special indemnity provision is capped, in aggregate, across all former stockholders at $10,250,000 through March 28, 2013, and is capped at $5 million through December 28, 2013, when the claim period expires. Our pro rata exposure to potential claims would be up to $487,000 through March 31, 2013, and up to $238,000 through December 31, 2013. As of September 30, 2012, no such claims had been made.

NOTE 12. SUBSEQUENT EVENTS

On October 1, 2012, the Company made a $200,000 follow-on investment in a privately held, equity-focused portfolio company.

On October 9, 2012, the Company made a $15,032 follow-on investment in a privately held, equity-focused portfolio company.

On October 12, 2012, we sold 500 written call option contracts in Solazyme, Inc., expiring on October 20, 2012, with a strike price of $10.00. We received premiums of approximately $15,520 for these contracts.

On October 20, 2012, a total of 1,532 written call option contracts in Solazyme, Inc., expired unexercised.

On October 23, 2012, the Company made a $1,000,000 follow-on investment in a privately held, equity-focused portfolio company.

On October 23, 2012, we sold 1,300 written call option contracts in Solazyme, Inc., expiring on November 17, 2012, with a strike price of $7.50. We received premiums of approximately $212,500 for these contracts.

On October 23, 2012, we purchased 1,300 put option positions in Solazyme, Inc., expiring on November 17, 2012, with a strike price of $7.50, for a payment of approximately $21,400.

On October 24, 2012, we sold 1,500 written call option contracts in NeoPhotonics Corporation, expiring on December 22, 2012, with a strike price of $5.00. We received premiums of approximately $95,250 for these contracts.

On October 29, 2012, the Company made a $2,445,000 follow-on investment in a privately held, equity-focused portfolio company.

On October 29, 2012, the Company made a $29,994 follow-on investment in a privately held, equity-focused portfolio company.

In October 2012, we sold 9,000 shares of Solazyme for proceeds of approximately $100,931.

As of September 30, 2012, we owned an aggregate of 1,938,190 shares of Solazyme. We valued this position at $22,269,803. The key input to our valuation of Solazyme was the share price as of the close of trading on September 28, 2012, which was $11.49. At September 30, 2012, this investment represented $0.72 of our net asset value per share. As of November 7, 2012, Solazyme's closing price was $7.56 per share, and we owned 1,929,190 shares of Solazyme. At this price, our shares of Solazyme are valued at $14,584,676, or $0.47 of our net asset value per share, as of November 7, 2012.

HARRIS & HARRIS GROUP, INC.

FINANCIAL HIGHLIGHTS

(Unaudited)

	Three Months Ended Sept. 30		Nine Months Ended Sept. 30	
	2012	2011	2012	2011
Per Share Operating Performance				
Net asset value per share, beginning of period	$4.88	$5.43	$4.70	$4.76
Net operating (loss)*	(0.05)	(0.07)	(0.22)	(0.18)
Net realized gain (loss) on investments*	0.09	(0.08)	0.14	0.08
Net (decrease) increase in unrealized appreciation as a result of sales*	(0.12)	0.09	(0.14)	(0.07)
Net (decrease) increase in unrealized appreciation on investments held and written call options* (1)	(0.04)	(1.00)	0.22	(0.25)
Total from investment operations*	(0.12)	(1.06)	0.00	(0.42)
Net increase as a result of stock- based compensation expense*	0.02	0.01	0.08	0.04
Total increase from capital stock transactions	0.02	0.01	0.08	0.04
Net asset value per share, end of period	$4.78	$4.38	$4.78	$4.38
Stock price per share, end of period	$3.79	$3.55	$3.79	$3.55
Total return based on stock price	(0.26)%	(30.80)%	9.54%	(18.95)%
Supplemental Data:				
Net assets, end of period	$148,160,377	$135,783,746	$148,160,377	$135,783,746
Ratio of expenses to average net assets	1.2%	1.5%	4.9%	4.2%
Ratio of net operating loss to average net assets	(1.0)%	(1.4)%	(4.6)%	(3.9)%
Average debt outstanding	$2,000,000	$2,126,087	$1,820,438	$1,289,194
Average debt per share	$0.06	$0.07	$0.06	$0.04
Number of shares outstanding, end of period	31,000,601	31,000,601	31,000,601	31,000,601

*Based on Average Shares Outstanding

(1) Net unrealized gains (losses) includes 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 unrealized losses on investments.

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, 2012, Consolidated Financial Statements and the Company's audited 2011 Consolidated Financial Statements and notes thereto.

Background

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.

Overview

We believe we provide five core benefits to our shareholders. First, we are an established firm with a positive track record of investing in venture capital-backed companies. Second, we provide shareholders with access to emerging nanotechnology-enabled companies that would otherwise be difficult to access or inaccessible for most current and potential shareholders. Third, we have an existing portfolio of companies at varying stages of maturity that provide for a potential pipeline of investment returns over time. Fourth, we are able to invest opportunistically in a range of types of securities to take advantage of market inefficiencies. Fifth, we provide access to venture capital investments in a vehicle that, unlike private venture capital firms, is both transparent and liquid.

We invest in companies enabled by nanotechnology and microsystems. We believe companies that leverage breakthroughs at the nanoscale are emerging as leaders in their respective industries. These companies primarily impact the energy, healthcare and electronics sectors. We focused the Company on making venture capital investments in companies that commercialize and integrate products enabled by nanotechnology beginning in 2002. We believe this was the period of time when nanotechnology was beginning to emerge from its gestational phase and entering its commercial phase. We believe the coming decades will be the period of time when the commercial impact of nanotechnology will become widespread. We believe that as this impact occurs, our portfolio companies are well positioned to profit and that we will see investment returns as a result.

We define venture capital investments as the money and resources made available to privately held and publicly traded small businesses with exceptional growth potential. We believe that we are the only U.S.-based, publicly traded venture capital company making investments exclusively in nanotechnology and microsystems. We believe we have invested in more nanotechnology-enabled companies than any other venture capital firm.

Nanotechnology and microsystems are technologies that allow for the characterization, design, manipulation and manufacture of materials and systems on the molecular and micro levels, respectively.

Nanotechnology is the study of technologies 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 industries, markets and products.

We believe nanotechnology can be classified as a transformative technology. An innovation qualifies as a transformative technology if it has the potential for pervasive use in a wide range of sectors in ways that change the competitive dynamics in those sectors. Transformative technologies often take decades to fully diffuse through respective sectors. We believe the period of 2001 through 2010 was the first decade in the commercial development of nanotechnology products. We believe we are currently in the second decade in the commercial development of nanotechnology products. We believe it will be this second decade and beyond where large portions of industry come to rely on nanotechnology as a fundamental enabler of advanced products.

Investment Objective and Strategy

Our principal investment objective is to achieve long-term capital appreciation by making equity-focused venture capital investments in companies that we believe have exceptional growth potential. 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 investment objective. 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 significant portions of our annual expenses during periods of time between realizations of capital gains on our investments. We also plan to implement a strategy to grow assets under management by raising one or more third-party funds to manage. It is possible that we will invest our capital alongside or through these funds in portfolio companies. These funds may be focused on investing in nanotechnology-enabled companies, or specific sectors such as life sciences, energy and electronics that are enabled by nanotechnology. It is also possible these funds will also invest in companies in each of these sectors that are not directly enabled by nanotechnology. There is no assurance when and if we will be able to raise such fund(s) or, if raised, whether they will be successful.

We have discretion in the investment of our capital to achieve our objectives. Our venture capital investments are made primarily in equity-related securities of companies that 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. These businesses may be privately held or publicly traded. We historically have invested in equity securities of these companies that are generally illiquid due to restrictions on resale and to the lack of an established trading market. We refer to our portfolio of investments in equity and equity-related securities in later sections of the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") as our "equity-focused" portfolio of investments. We may take advantage of opportunities to generate near-term cash flow by investing in non-convertible debt securities of small businesses. These businesses tend to be generating cash or have near-term visibility to reaching positive cash flow. We refer to our portfolio of investments in non-convertible debt in later sections of the MD&A as our "venture debt" portfolio of investments.

We are both early-stage and long-term investors. We seek to identify investment opportunities in industries and markets that will be growth opportunities three to seven years from the date of our initial investment. We expect to invest capital in these companies at multiple points in time subsequent to our initial investment. We refer to such investments as "follow-on" investments. Our efforts to identify and predict future growth industries and markets rely on patient and deep due diligence in nanotechnology-enabled innovations developed at universities and corporate and government research laboratories, and the examination of macroeconomic and microeconomic trends and industry dynamics. We believe it is the early identification of and investments in these growth opportunities that will lead to investment returns for our shareholders, growth of our net assets, and capital for us to invest in tomorrow’s growth opportunities.

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, 2012, we held at least one board seat or observer rights on 23 of our 28 equity-focused portfolio companies (82 percent). We have not held a board seat or observer rights at either Solazyme, Inc., or NeoPhotonics Corporation since each company completed an initial public offering in May 2011 and February 2011, respectively.

Investments and Current Investment Pace

Since our investment in Otisville in 1983 through September 30, 2012, we have made a total of 94 equity-focused venture capital investments. We have completely exited 66 of these 94 investments and partially exited through the sale of shares and/or the sale of call options covered by shares of two of these 94 investments, recognizing aggregate net realized gains of $71,772,396 on invested capital of $92,754,150. For the securities of the 28 companies in our equity-focused portfolio held at September 30, 2012, we have net unrealized appreciation of $11,435,725 on invested capital of $107,328,018. We have aggregate net realized and unrealized appreciation for our 94 equity-focused investments of $83,208,121 on invested capital of $200,082,168.

The amount of net realized gains includes:

- $13,992,952 in upfront payments received in 2011 from the sale of BioVex Group, Inc., to Amgen, Inc., the sale of Innovalight, Inc., to E.I. du Pont de Nemours and Company ("DuPont") and the sale of Crystal IS, Inc., to Asahi Kasei Group. We had invested a total of $11,383,299 in these three portfolio companies;
- $953,480 from the portion of our upfront payment held in escrow from the sale of BioVex Group, Inc., to Amgen, Inc., which was released on March 16, 2012;
- $11,140 from the portion of our upfront payment held in escrow from the sale of Crystal IS, Inc., to Asahi Kasei Group, which was released on April 30, 2012;
- $4,112,340 from the sale of shares of Solazyme, Inc., on invested capital of $863,928. $1,926,000 of the total proceeds was generated from the call of shares of Solazyme under option contracts. $2,186,340 in total proceeds was generated from the sale of 173,359 shares of Solazyme through open market transactions; and
- $458,911 in realized gains on our sale of call option covered by our shares of NeoPhotonics Corporation and Solazyme, Inc.

The aggregate net realized gains and the cumulative invested capital also do not reflect the cost or value of our shares of NeoPhotonics Corporation or Solazyme, Inc., which completed IPOs on February 2, 2011, and May 27, 2011, respectively, that we owned as of September 30, 2012. The aggregate net realized gains also do not include potential escrow payments from the sale of Crystal IS, Inc., or Innovalight, Inc., or potential milestone payments that could occur as part of the acquisition of BioVex Group, Inc., by Amgen, Inc., at points in time in the future as of September 30, 2012.

From August 2001 through September 30, 2012, all 52 of our initial equity-focused investments have been in companies commercializing or integrating products enabled by nanotechnology or microsystems. From August 2001 through September 30, 2012, we have invested a total (before any subsequent write-ups, write-downs or dispositions) of $153,096,224 in these companies. We currently have 26 equity-focused companies in our portfolio that have yet to complete liquidity events (e.g., IPO or M&A). At September 30, 2012, from first dollar in, the average and median holding periods for these 26 investments were 5.3 years and 5.5 years, respectively. Historically, as measured from first dollar in to last dollar out, the average and median holding periods for the 66 investments we have fully exited were 4.2 years and 3.3 years, respectively.

The following is a summary of our initial and follow-on equity-focused investments in nanotechnology companies from January 1, 2008, to September 30, 2012. We consider a "round led" to be a round where we were the new investor or the leader of a group 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.

Investments in Our Equity-Focused Portfolio of Investments
in Privately Held and Publicly Traded Companies

	2008	2009	2010	2011	**Nine Months Ended September 30, 2012**
Total Incremental Investments	$17,779,462	$12,334,051	$9,560,721	$17,688,903	$ 9,097,840
No. of New Investments	4	2	3	4	1
No. of Follow-On Investment Rounds	25	29	27	31	19
No. of Rounds Led	4	5	5	4	2
Average Dollar Amount – Initial	$683,625	$174,812	$117,069	$1,339,744	$ 815,000
Average Dollar Amount – Follow-On	$601,799	$413,256	$341,093	$397,740	$ 435,939

During the first nine months of 2012, we made one new venture debt investment. The following is a summary of our investments in venture debt to date.

Investments in Our Venture Debt Portfolio of Investments
In Privately Held and Publicly Traded Companies

	2008	2009	2010	2011	**Nine Months Ended Septmber 30, 2012**
No. of Investments	0	0	1	3	1
Total Dollar Amount	$ 0	$ 0	$500,000	$1,400,000	$ 720,000

In the fourth quarter of 2011, we made a $500,000 venture debt investment in an equity-focused portfolio company, Ancora Pharmaceuticals Inc. We note that all amounts, values and numbers mentioned below regarding our equity-focused portfolio companies include this investment in those calculations.

Our Sources of Liquid Capital

The sources of liquidity that we use to make our investments are classified as primary and secondary liquidity. As of September 30, 2012, and December 31, 2011, our total primary and secondary liquidity was $52,912,350 and $65,368,303, respectively. We do not include funds available from our credit facility as primary or secondary liquidity. We believe it is important to examine both our primary and secondary liquidity when assessing the strength of our balance sheet and our future investment capabilities.

Primary liquidity is comprised of cash, U.S. Treasury securities and certain receivables. As of September 30, 2012, we held $10,000,000 in U.S. government obligations, and we had an additional $16,556,886 in cash, of which $11,905,005 was held in non-interest-bearing, fully FDIC insured bank accounts. On March 16, 2012, the Company received payment of its portion of the proceeds held in escrow since the closing of the transaction on March 4, 2011, from Amgen, Inc.'s acquisition of BioVex Group, Inc., totaling $953,480. On April 30, 2012, the Company received $11,140 from the portion of our upfront payment held in escrow from the sale of Crystal IS, Inc., to Asahi Kasei Group. These payments immediately added to our primary liquidity. Payments upon achieving milestones of the BioVex Group, Inc., sale or expiration of the escrow periods for the Crystal IS, Inc., and Innovalight, Inc., dispositions would also add to our primary liquidity in future quarters if these milestones are achieved successfully and escrowed funds are released in part or in full. The probability-adjusted values of the future milestone payments for the sale of BioVex and of the funds held in escrow from the dispositions of Crystal IS and Innovalight, as determined at the end of each fiscal quarter, are included as an asset on our Consolidated Statements of Assets and Liabilities and will be included in primary liquidity only if and when payment is received for achievement of the milestones and the funds held in escrow are released, respectively. During the three months and nine months ended September 30, 2012, 104,300 and 192,600 shares, respectively, of our investment in Solazyme, Inc., were called under option contracts. In total, we received $4,112,340 in gross proceeds from these transactions, which added to our primary liquidity. We also sold an additional 173,359 shares of Solazyme on the open market during this period.

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Our secondary liquidity is comprised of the stock of publicly traded companies. Although these companies are publicly traded, their stock may not trade at high volumes and prices may be volatile, which may restrict our ability to sell our positions at any given time. As of September 30, 2012, our secondary liquidity was $26,217,767. NeoPhotonics Corporation and Solazyme, Inc., account for $24,903,100 of this amount based on the closing price of each company as of September 30, 2012. As of September 30, 2012, shares of NeoPhotonics were trading below the strike price of the call options that were open and outstanding. The $10.00 Solazyme option contracts were in the money at September 30, 2012. The fair value of our shares of Champions Oncology, Inc., accounts for $1,314,667 of the total amount of secondary liquidity. As of September 30, 2012, our shares of each of these companies are freely tradable securities. A decision to sell our shares would result in the cash received from the sale of these assets being included in primary liquidity. Until that time, we will continue to include the value of our shares of our publicly traded portfolio companies in secondary liquidity unless the average trading volume of each company reaches sufficient levels for us to monetize our stock in such companies over a short period of time.

Potential Pending Liquidity Events from Our Portfolio as of September 30, 2012

As of the end of the third quarter of 2012, six of our companies have commenced planning for and/or began the process of pursuing potential sales and/or IPOs of those companies within the next six to twelve months. These companies have either begun the process of hiring or have hired bankers and/or advisors to attempt to pursue such liquidity events or are in discussions with potential acquirers of those companies. As of September 30, 2012, these efforts are ongoin