

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

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

Form 10-Q

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

For the quarterly period ended March 31, 2010

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-11576

HARRIS & HARRIS GROUP, INC.

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(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

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(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

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

Yes ☒ No ☐

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

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Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

Yes ☐ No ☒

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

Class	Outstanding at May 10, 2010
Common Stock, \$0.01 par value per share	30,864,899 shares

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## PART I. FINANCIAL INFORMATION

### Item 1. Consolidated Financial Statements

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

Harris & Harris Group, Inc.® (the "Company," "us," "our" and "we"), is an internally managed venture capital company that has elected to operate as a business development company ("BDC") under the Investment Company Act of 1940 (the "1940 Act"). Certain information and disclosures normally included in the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted as permitted by Regulation S-X and Regulation S-K. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2009, contained in our Annual Report on Form 10-K for the year ended December 31, 2009.

In September 1997, our Board of Directors approved a proposal to seek qualification as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code (the "Code"). At that time, we were taxable under Subchapter C of the Code (a "C Corporation"). We filed for the 1999 tax year to elect treatment as a RIC. 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. In addition to the requirement that we must annually distribute at least 90 percent of our investment company taxable income, we may either distribute or retain our net capital gain from investments, but any net capital gain not distributed will be subject to corporate income tax and the excise tax described below. We will be subject to a four percent excise tax to the extent we fail to distribute at least 98 percent of our annual net ordinary income and 98 percent of our capital gain net income and would be subject to income tax to the extent we fail to distribute 100 percent of our investment company taxable income.

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

On June 9, 2009, we received SEC certification for 2008, permitting us to qualify for RIC treatment for 2008 (as we had for the years 1999 through 2007) pursuant to Section 851(e) of the Code. Although the SEC certification for 2008 was issued, there can be no assurance that we will qualify for or receive such certification for subsequent years (to the extent we need additional certification as a result of changes in our portfolio) or that we will actually qualify for Subchapter M treatment in subsequent years. On April 23, 2010, we applied for SEC certification for 2009. We qualified for RIC treatment in 2009 even without certification. In addition, under certain circumstances, even if we qualified for Subchapter M treatment in a given year, we might take action in a subsequent year to ensure that we would be taxed in that subsequent year as a C Corporation, rather than as a RIC. Because Subchapter M does not permit deduction of operating expenses against net capital gain, it is not clear that the Company and its shareholders have paid less in taxes since 1999 than they would have paid had the Company remained a C Corporation.

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

ASSETS

	March 31, 2010 (Unaudited)	December 31, 2009
Investments, in portfolio securities at value:		
Unaffiliated privately held companies (cost: \$31,002,395 and \$26,977,200, respectively)	\$ 29,752,075	\$ 21,656,436
Unaffiliated publicly traded securities (cost: \$547,304 and \$298,827, respectively)	552,454	226,395
Non-controlled affiliated privately held companies (cost: \$51,546,166 and \$54,864,948, respectively)	45,559,645	50,297,220
Controlled affiliated privately held companies (cost: \$11,032,574 and \$10,248,932, respectively)	7,703,226	5,843,430
Total, investments in privately held and publicly traded securities at value (cost: \$94,128,439 and \$92,389,907, respectively)	\$ 83,567,400	\$ 78,023,481
Investments, in U.S. Treasury obligations at value (cost: \$53,163,696 and \$55,960,024, respectively)	53,160,430	55,947,581
Cash	197,294	1,611,465
Restricted funds	2,000	2,000
Receivable from portfolio company	0	28,247
Interest receivable	6	25,832
Prepaid expenses	338,542	94,129
Receivable from unsettled trade	799,925	0
Other assets	691,853	376,366
Total assets	\$ 138,757,450	\$ 136,109,101

LIABILITIES & NET ASSETS

Post retirement plan liabilities	\$ 1,402,894	\$ 1,369,843
Accounts payable and accrued liabilities	672,902	579,162
Deferred rent	321,372	1,838
Total liabilities	2,397,168	1,950,843
Net assets	\$ 136,360,282	\$ 134,158,258
Net assets are comprised of:		
Preferred stock, \$0.10 par value, 2,000,000 shares authorized; none issued	\$ 0	\$ 0
Common stock, \$0.01 par value, 45,000,000 shares authorized at 03/31/10 and 12/31/09; 32,690,986 issued at 03/31/10 and 32,688,333 issued at 12/31/09	326,911	326,884
Additional paid in capital (Note 8)	206,491,383	205,977,117
Accumulated net operating and realized loss	(56,488,176)	(54,361,343)

Accumulated unrealized depreciation of investments	(10,564,305)	(14,378,869)
Treasury stock, at cost (1,828,740 shares at 03/31/10 and 12/31/09)	(3,405,531)	(3,405,531)
Net assets	\$ 136,360,282	\$ 134,158,258
Shares outstanding	30,862,246	30,859,593
Net asset value per outstanding share	\$ 4.42	\$ 4.35

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

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Investment income:		
Interest from:		
Fixed-income securities and bridge notes (Note 3)	\$ 73,073	\$ (35,899)
Miscellaneous income	6,000	12,338
Total investment income (loss)	79,073	(23,561)
Expenses:		
Salaries, benefits and stock-based compensation (Note 6)	1,389,277	1,387,340
Administration and operations	282,522	290,435
Professional fees	243,369	215,250
Rent (Note 3)	77,215	78,063
Directors' fees and expenses	95,361	84,509
Depreciation	11,969	12,859
Custody fees	24,000	6,862
Lease termination costs (Note 3)	68,038	0
Total expenses	2,191,751	2,075,318
Net operating loss	(2,112,678)	(2,098,879)
Net realized loss:		
Realized loss from investments:		
Unaffiliated companies	0	(3,288)
Non-controlled affiliated companies	0	0
Controlled affiliated companies	0	0
U.S. Treasury obligations/other	(11,523)	(325)
Realized loss from investments	(11,523)	(3,613)
Income tax expense (Note 7)	2,632	380
Net realized loss	(14,155)	(3,993)
Net decrease in unrealized depreciation on investments:		
Change on investments held	3,814,564	1,151,448
Net decrease in unrealized depreciation on investments	3,814,564	1,151,448
Net increase (decrease) in net assets resulting from operations:		
Total	\$ 1,687,731	\$ (951,424)



Per average basic and diluted outstanding share	\$	0.05	\$	(0.04)
Average outstanding shares		30,859,888		25,859,573

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

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

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Cash flows (used in) provided by operating activities:		
Net increase (decrease) in net assets resulting from operations	\$ 1,687,731	\$ (951,424)
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash used in operating activities:		
Net realized and unrealized (gain) on investments	(3,803,041)	(1,147,835)
Depreciation of fixed assets, amortization of premium or discount on U.S. government securities, and bridge note interest	(41,107)	86,269
Stock-based compensation expense	553,272	635,638
Changes in assets and liabilities:		
Restricted funds	0	(618)
Receivable from portfolio company	28,247	0
Interest receivable	12,589	54,660
Receivable from investments sold	(799,925)	0
Prepaid expenses	(244,413)	137,680
Other assets	(260,892)	3,312
Post retirement plan liabilities	33,051	30,981
Accounts payable and accrued liabilities	93,740	(131,084)
Deferred rent	319,534	(1,576)
Net cash used in operating activities	(2,421,214)	(1,283,997)
Cash flows from investing activities:		
Purchase of U.S. government securities	(2,399,293)	(52,334,768)
Sale of U.S. government securities	5,199,533	53,892,347
Investment in venture capital investments	(1,675,058)	(723,176)
Proceeds from conversion of bridge note	1,356	0
Purchase of fixed assets	(80,516)	(1,313)
Net cash provided by investing activities	1,046,022	833,090
Cash flows from financing activities:		
Proceeds from stock option exercises	9,949	0
Payment of offering costs	(48,928)	0
Net cash used in financing activities	(38,979)	0
Net decrease in cash:		

Cash at beginning of the period	1,611,465	692,309
Cash at end of the period	197,294	241,402
Net decrease in cash	\$ (1,414,171)	\$ (450,907)
Supplemental disclosures of cash flow information:		
Income taxes paid	\$ 2,632	\$ 380

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

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

	Three Months Ended March 31, 2010 (Unaudited)	Year Ended December 31, 2009
Changes in net assets from operations:		
Net operating loss	\$ (2,112,678)	\$ (8,761,215)
Net realized loss on investments	(14,155)	(11,105,577)
Net decrease in unrealized depreciation on investments as a result of sales	0	11,090,579
Net decrease in unrealized depreciation on investments held	3,814,564	8,627,748
Net increase (decrease) in net assets resulting from operations	1,687,731	(148,465)
Changes in net assets from capital stock transactions:		
Issuance of common stock upon the exercise of stock options	27	1,125
Issuance of common stock on offering	0	48,875
Additional paid-in capital on common stock issued and options exercised	(39,006)	21,636,090
Stock-based compensation expense	553,272	3,089,520
Net increase in net assets resulting from capital stock transactions	514,293	24,775,610
Net increase in net assets	2,202,024	24,627,145
Net assets:		
Beginning of the period	134,158,258	109,531,113
End of the period	\$ 136,360,282	\$ 134,158,258

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2010  
(Unaudited)

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3)(4) – 22.2% of net assets at value			
Private Placement Portfolio (Illiquid) – 21.8% of net assets at value			
BioVex Group, Inc. (5)(6)(7)(8) -- Developing novel biologics for treatment of cancer and infectious disease			
Series E Convertible Preferred Stock	(M)	2,799,552	\$ 1,042,862
Series G Convertible Preferred Stock	(M)	3,738,004	627,985
Warrants at \$0.21 expiring 11/5/16	( I )	285,427	18,838
			1,689,685
Bridgelux, Inc. (5)(6) -- Manufacturing high-power light emitting diodes (LEDs) and arrays			
Series B Convertible Preferred Stock	(M)	1,861,504	2,345,495
Series C Convertible Preferred Stock	(M)	2,130,699	2,684,681
Series D Convertible Preferred Stock	(M)	999,999	1,259,999
Warrants at \$0.7136 expiring 12/31/14	( I )	163,900	135,218
Warrants at \$1.50 expiring 8/26/14	( I )	166,665	101,332
			6,526,725
Cobalt Technologies, Inc. (5)(6)(7)(9) -- Developing processes for making biobutanol through biomass fermentation			
Series C Convertible Preferred Stock	(M)	352,112	375,000
D-Wave Systems, Inc. (5)(6)(7)(10) -- Developing high- performance quantum computing systems			
Series B Convertible Preferred Stock	(M)	1,144,869	938,620
Series C Convertible Preferred Stock	(M)	450,450	369,301

Series D Convertible Preferred Stock	(M)	1,533,395	1,257,153
			2,565,074

Molecular Imprints, Inc. (5)(6) -- Manufacturing  
nanoimprint

lithography capital equipment			
Series B Convertible Preferred Stock	(M)	1,333,333	2,999,999
Series C Convertible Preferred Stock	(M)	1,250,000	2,812,500
Warrants at \$2.00 expiring 12/31/11	( I )	125,000	155,375
			5,967,874

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

HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2010  
(Unaudited)

	Method of Valuation (1)	Shares/ Principal	Value
Investments in Unaffiliated Companies (2)(3)(4) – 22.2% of net assets at value (Cont.)			
Private Placement Portfolio (Illiquid) – 21.8% of net assets at value (Cont.)			
Nanosys, Inc. (5)(6) -- Developing inorganic materials and devices based on nanowires and quantum dots &			