HARRIS & HARRIS GROUP INC /NY/
Form 10-Q
November 06, 2009

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, 2009

o 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<br>(State or Other Jurisdiction of Incorporation or Organization) | 13-3119827<br>(I.R.S. Employer Identification No.) |
| 111 West 57th Street, New York, New York<br>(Address of Principal Executive Offices) | 10019<br>(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 x 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 ¨ (Do not check if a smaller reporting company) | 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 6, 2009 |
|---|---|
| Common Stock, $0.01 par value per share | 30,854,258 shares |

Harris & Harris Group, Inc.
Form 10-Q, September 30, 2009

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 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, 2008, contained in our Annual Report on Form 10-K for the year ended December 31, 2008.

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. In 2008, we qualified for RIC treatment 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

| | | September 30, 2009 (Unaudited) | | December 31, 2008 |
|---|---|---|---|---|
| Investments, in portfolio securities at value: | | | | |
| Unaffiliated companies (cost: $26,648,390 and $24,208,281, respectively) | $ | 16,892,041 | $ | 12,086,503 |
| Non-controlled affiliated companies (cost: $60,109,424 and $60,796,720, respectively) | | 48,920,403 | | 39,650,187 |
| Controlled affiliated companies (cost: $6,996,458 and $6,085,000, respectively) | | 4,063,766 | | 5,228,463 |
| Publicly traded securities (cost: $199,432 and $0, respectively) | | 173,405 | | 0 |
| Total, investments in private portfolio companies and public securities at value (cost: $93,953,704 and $91,090,001, respectively) | $ | 70,049,615 | $ | 56,965,153 |
| Investments, in U.S. Treasury obligations at value (cost: $66,960,793 and $52,956,288, respectively) | | 66,971,440 | | 52,983,940 |
| Cash and cash equivalents | | 1,495,970 | | 692,309 |
| Restricted funds | | 1,985 | | 191,955 |
| Interest receivable | | 6,517 | | 56 |
| Prepaid expenses | | 148,653 | | 484,567 |
| Other assets | | 462,253 | | 309,621 |
| Total assets | $ | 139,136,433 | $ | 111,627,601 |

LIABILITIES & NET ASSETS

| | | September 30, 2009 | | December 31, 2008 |
|---|---|---|---|---|
| Payable for investments purchased | $ | 25,720,198 | $ | 0 |
| Accounts payable and accrued liabilities | | 1,880,616 | | 2,088,348 |
| Deferred rent | | 3,413 | | 8,140 |
| Total liabilities | | 27,604,227 | | 2,096,488 |
| | | | | |
| Net assets | $ | 111,532,206 | $ | 109,531,113 |
| | | | | |
| 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 9/30/09 and 12/31/08; 27,795,498 issued at 9/30/09 and 27,688,313 issued at 12/31/08 | | 277,956 | | 276,884 |
| Additional paid in capital (Note 8) | | 184,077,904 | | 181,251,507 |
| Accumulated net operating and realized loss | | (45,524,681) | | (34,494,551) |
| Accumulated unrealized depreciation of investments | | (23,893,442) | | (34,097,196) |
| Treasury stock, at cost (1,828,740 shares at 9/30/09 and 12/31/08) | | (3,405,531) | | (3,405,531) |

| | | |
|---|---|---|
| Net assets | $ 111,532,206 | $ 109,531,113 |
| Shares outstanding | 25,966,758 | 25,859,573 |
| Net asset value per outstanding share | $ 4.30 | $ 4.24 |

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

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

| | Three Months Ended Sept. 30 2009 | Three Months Ended Sept. 30 2008 | Nine Months Ended Sept. 30 2009 | Nine Months Ended Sept. 30 2008 |
|---|---|---|---|---|
| Investment income: | | | | |
| Interest from: | | | | |
| Fixed-income securities and bridge notes | $ 99,677 | $ 585,418 | $ 138,862 | $ 1,626,176 |
| Miscellaneous income | 6,000 | 2,500 | 27,088 | 5,669 |
| Total investment income | 105,677 | 587,918 | 165,950 | 1,631,845 |
| | | | | |
| Expenses: | | | | |
| Salaries, benefits and stock-based compensation (Note 6) | 1,727,743 | 2,205,980 | 4,621,680 | 7,101,077 |
| Administration and operations | 225,044 | 252,884 | 746,640 | 838,100 |
| Professional fees | 190,942 | 138,461 | 558,483 | 478,559 |
| Rent | 79,617 | 80,358 | 236,678 | 197,960 |
| Directors' fees and expenses | 79,136 | 79,318 | 252,745 | 263,633 |
| Depreciation | 12,633 | 13,447 | 38,370 | 41,251 |
| Custodian fees | 33,515 | 14,209 | 51,457 | 26,905 |
| Total expenses | 2,348,630 | 2,784,657 | 6,506,053 | 8,947,485 |
| | | | | |
| Net operating loss | (2,242,953) | (2,196,739) | (6,340,103) | (7,315,640) |
| | | | | |
| Net realized (loss) gain from investments: | | | | |
| Realized (loss) gain from: | | | | |
| Unaffiliated companies | 0 | 0 | (1,514,330) | 3,420 |
| Non-Controlled affiliated companies | (3,176,125) | (1,478,500) | (3,176,125) | (6,493,153) |
| Controlled affiliated companies | 0 | (2,893,487) | 0 | (2,893,487) |
| U.S. Treasury obligations/other | 0 | (1,137) | (325) | (862) |
| Realized loss from investments | (3,176,125) | (4,373,124) | (4,690,780) | (9,384,082) |
| | | | | |
| Income tax (benefit) expense (Note 7) | (2,862) | 2,102 | (753) | 48,968 |
| Net realized loss from investments | (3,173,263) | (4,375,226) | (4,690,027) | (9,433,050) |
| | | | | |
| Net decrease (increase) in unrealized depreciation on investments: | | | | |
| Change as a result of investment sales | 3,180,240 | 4,278,500 | 4,691,282 | 9,293,153 |
| Change on investments held | 1,939,657 | (31,739,282) | 5,512,472 | (28,511,536) |
| Net decrease (increase) in unrealized depreciation on investments | 5,119,897 | (27,460,782) | 10,203,754 | (19,218,383) |
| | | | | |
| Net decrease in net assets resulting from operations | $ (296,319) | $ (34,032,747) | $ (826,376) | $ (35,967,073) |
| | | | | |
| Per average basic and diluted outstanding share | $ (0.01) | $ (1.32) | $ (0.03) | $ (1.48) |
| | | | | |
| Average outstanding shares | 25,866,983 | 25,859,573 | 25,862,070 | 24,271,270 |

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

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

| | Nine Months Ended September 30, 2009 | Nine Months Ended September 30, 2008 |
|---|---|---|
| Cash flows used in operating activities: | | |
| Net decrease in net assets resulting from operations | $ (826,376) | $ (35,967,073) |
| Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities: | | |
| Net realized and unrealized (gain) loss on investments | (5,512,974) | 28,602,465 |
| Depreciation of fixed assets, amortization of premium or discount on U.S. government securities, and bridge note interest | 39,784 | (160,283) |
| Stock-based compensation expense | 2,425,525 | 4,333,892 |
| | | |
| Changes in assets and liabilities: | | |
| Restricted funds | 189,970 | 2,542,356 |
| Receivable from portfolio company | 0 | 524 |
| Other receivables | (217) | 0 |
| Interest receivable | 2,044 | 213,520 |
| Income tax receivable | (3,353) | 0 |
| Prepaid expenses | 335,914 | 340,152 |
| Other assets | (186,116) | 1,619 |
| Accounts payable and accrued liabilities | (207,732) | (2,562,338) |
| Deferred rent | (4,727) | (4,810) |
| | | |
| Net cash used in operating activities | (3,748,258) | (2,659,976) |
| | | |
| Cash flows from investing activities: | | |
| Purchase of U.S. government securities | (112,308,457) | (75,932,334) |
| Sale of U.S. government securities | 123,988,254 | 79,326,692 |
| Investment in private placements and notes | (7,535,874) | (14,635,185) |
| Proceeds from sale of investments | 7,365 | 140,257 |
| Purchase of fixed assets | (1,313) | (15,046) |
| | | |
| Net cash provided by (used in) investing activities | 4,149,975 | (11,115,616) |
| | | |
| Cash flows from financing activities: | | |
| Proceeds from stock option exercises (Note 6) | 401,944 | 0 |
| Proceeds from stock offering (Note 8) | 0 | 14,383,497 |
| | | |
| Net cash provided by financing activities | 401,944 | 14,383,497 |
| | | |
| Net increase in cash and cash equivalents: | | |
| Cash and cash equivalents at beginning of the period | 692,309 | 330,009 |

| | | | | |
|---|---|---|---|---|
| Cash and cash equivalents at end of the period | | 1,495,970 | | 937,914 |
| | | | | |
| Net increase in cash and cash equivalents | $ | 803,661 | $ | 607,905 |
| | | | | |
| Supplemental disclosures of cash flow information: | | | | |
| Income taxes paid | $ | 2,179 | $ | 48,427 |

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, 2009 (Unaudited) | Year Ended December 31, 2008 |
|---|---|---|
| Changes in net assets from operations: | | |
| Net operating loss | $ (6,340,103) | $ (10,687,151) |
| Net realized loss on investments | (4,690,027) | (8,323,634) |
| Net decrease in unrealized depreciation on investments as a result of sales | 4,691,282 | 8,292,072 |
| Net decrease (increase) in unrealized depreciation on investments held | 5,512,472 | (38,462,784) |
| Net decrease in net assets resulting from operations | (826,376) | (49,181,497) |
| Changes in net assets from capital stock transactions: | | |
| Issuance of common stock | 1,072 | 25,450 |
| Additional paid-in capital on common stock issued | 400,872 | 14,358,047 |
| Stock-based compensation expense | 2,425,525 | 5,965,769 |
| Net increase in net assets resulting from capital stock transactions | 2,827,469 | 20,349,266 |
| Net increase (decrease) in net assets | 2,001,093 | (28,832,231) |
| Net assets: | | |
| Beginning of the period | 109,531,113 | 138,363,344 |
| End of the period | $ 111,532,206 | $ 109,531,113 |

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, 2009
(Unaudited)

| | Method of Valuation (1) | Shares/ Principal | | Value |
|---|---|---|---|---|
| Investments in Unaffiliated Companies (2)(3)(4)– 15.3% of net assets at value | | | | |
| Private Placement Portfolio (Illiquid) – 15.1% of net assets at value | | | | |
| BioVex Group, Inc. (5)(6)(7)(8) -- Developing novel biologics for treatment of cancer and infectious disease | | | | |
| Series E Convertible Preferred Stock | (M) | 2,799,552 | $ | 470,325 |
| Series F Convertible Preferred Stock | (M) | 2,011,110 | | 388,669 |
| Warrants at $0.241576 expiring 11/13/15 | ( I ) | 248,120 | | 18,838 |
| | | | | 877,832 |
| 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 | | 1,184,568 |
| Series C Convertible Preferred Stock | (M) | 450,450 | | 466,070 |
| Series D Convertible Preferred Stock | (M) | 1,533,395 | | 1,586,566 |
| | | | | 3,237,204 |
| Molecular Imprints, Inc. (5)(6) -- Manufacturing nanoimprint lithography capital equipment | | | | |
| Series B Convertible Preferred Stock | (M) | 1,333,333 | | 1,625,000 |
| Series C Convertible Preferred Stock | (M) | 1,250,000 | | 1,523,438 |
| Warrants at $2.00 expiring 12/31/11 | ( I ) | 125,000 | | 48,750 |
| | | | | 3,197,188 |
| Nanosys, Inc. (5)(6) -- Developing zero and one-dimensional inorganic nanometer-scale materials and devices | | | | |
| Series C Convertible Preferred Stock | (M) | 803,428 | | 1,185,056 |
| Series D Convertible Preferred Stock | (M) | 1,016,950 | | 1,500,001 |
| | | | | 2,685,057 |

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

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HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2009
(Unaudited)

| | Method of Valuation (1) | Shares/ Principal | | Value |
|---|---|---|---|---|
| Investments in Unaffiliated Companies (2)(3)(4)– 15.3% of net assets at value (Cont.) | | | | |
| Private Placement Portfolio (Illiquid) – 15.1% of net assets at value (Cont.) | | | | |
| | | | | |
| Nantero, Inc. (5)(6)(7) -- Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes | | | | |
| Series A Convertible Preferred Stock | (M) | 345,070 | $ | 1,046,908 |
| Series B Convertible Preferred Stock | (M) | 207,051 | | 628,172 |
| Series C Convertible Preferred Stock | (M) | 188,315 | | 571,329 |
| | | | | 2,246,409 |
| | | | | |
| NeoPhotonics Corporation (5)(6) -- Developing and manufacturing optical devices and components | | | | |
| Common Stock | (M) | 716,195 | | 413,244 |
| Series 1 Convertible Preferred Stock | (M) | 1,831,256 | | 1,056,634 |
| Series 2 Convertible Preferred Stock | (M) | 741,898 | | 428,075 |
| Series 3 Convertible Preferred Stock | (M) | 2,750,000 | | 1,586,750 |
| Series X Convertible Preferred Stock | (M) | 2,000 | | 230,800 |
| Warrants at $0.15 expiring 01/26/10 | ( I ) | 16,364 | | 7,004 |
| Warrants at $0.15 expiring 12/05/10 | ( I ) | 14,063 | | 6,272 |
| | | | | 3,728,779 |
| | | | | |
| Polatis, Inc. (5)(6)(7) -- Developing MEMS-based optical networking components | | | | |
| Series A-1 Convertible Preferred Stock | (M) | 16,775 | | 0 |
| Series A-2 Convertible Preferred Stock | (M) | 71,611 | | 0 |
| Series A-4 Convertible Preferred Stock | (M) | 4,774 | | 0 |
| Series A-5 Convertible Preferred Stock | (M) | 16,438 | | 0 |
| | | | | 0 |
| | | | | |
| PolyRemedy, Inc. (5)(6)(7) -- Developing a robotic manufacturing platform for wound treatment patches | | | | |
| Series B-1 Convertible Preferred Stock | (M) | 287,647 | | 93,866 |
| Series B-2 Convertible Preferred Stock | (M) | 676,147 | | 121,706 |
| | | | | 215,572 |

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, 2009
(Unaudited)

| | Method of Valuation (1) | Shares/ Principal | | Value |
|---|---|---|---|---|
| Investments in Unaffiliated Companies (2)(3)(4)– 15.3% of net assets at value (Cont.) | | | | |
| Private Placement Portfolio (Illiquid) – 15.1% of net assets at value (Cont.) | | | | |
| Siluria Technologies, Inc. (5)(6)(7) -- Developing next-generation nanomaterials | | | | |
| Series S-2 Convertible Preferred Stock | (M) | 612,061 | $ | 204,000 |
| Starfire Systems, Inc. (5)(6)(11) -- Producing ceramic-forming polymers | | | | |
| Common Stock | (M) | 375,000 | | 0 |
| Series A-1 Convertible Preferred Stock | (M) | 600,000 | | 0 |
| | | | | 0 |
| TetraVitae Bioscience, Inc. (5)(6)(7)(12) -- Developing methods of producing alternative chemicals and fuels through biomass fermentation | | | | |
| Series B Convertible Preferred Stock | (M) | 118,804 | | 125,000 |
| Total Unaffiliated Private Placement Portfolio (cost: $26,648,390) | | | $ | 16,892,041 |
| Publicly Traded Portfolio (Liquid) – 0.2% of net assets at value | | | | |
| Orthovita, Inc. (6)(13) -- Developing materials and devices for orthopedic medical implant applications | | | | |
| Common Stock | (M) | 39,500 | | 173,405 |
| Total Unaffiliated Publicly Traded Portfolio (cost: $199,432) | | | $ | 173,405 |
| Total Investments in Unaffiliated Companies (cost: $26,847,822) | | | $ | 17,065,446 |

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

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2009
(Unaudited)

| | Method of Valuation (1) | Shares/ Principal | Value |
|---|---|---|---|
| Investments in Non-Controlled Affiliated Companies (2)(14) – 43.9% of net assets at value | | | |
| | | | |
| Private Placement Portfolio (Illiquid) – 43.9% of net assets at value | | | |
| | | | |
| | | | |
| Adesto Technologies Corporation (5)(6)(7) -- Developing low-power, high-performance memory devices | | | |
| Series A Convertible Preferred Stock | (M) | 6,547,619 | $ 2,420,000 |
| Series B Convertible Preferred Stock | (M) | 5,952,381 | 2,200,000 |
| | | | 4,620,000 |
| | | | |
| Ancora Pharmaceuticals Inc. (5)(6)(7) -- Developing synthetic carbohydrates for pharmaceutical applications | | | |
| Series B Convertible Preferred Stock | (M) | 1,663,808 | 34,940 |
| Secured Convertible Bridge Note (including interest) | (M) | $ 325,000 | 327,307 |
| | | | 362,247 |
| | | | |
| BridgeLux, Inc. (5)(6) -- Manufacturing high-power light emitting diodes (LEDs) and arrays | | | |
| Series B Convertible Preferred Stock | (M) | 1,861,504 | 1,804,914 |
| Series C Convertible Preferred Stock | (M) | 2,130,699 | 2,065,926 |
| Series D Convertible Preferred Stock | (M) | 833,333 | 807,999 |
| Warrants at $0.7136 expiring 12/31/14 | ( I ) | 163,900 | 102,602 |
| Warrants at $1.50 expiring 8/26/14 | ( I ) | 124,999 | 59,250 |
| | | | 4,840,691 |
| | | | |
| Cambrios Technologies Corporation (5)(6)(7) – Developing nanowire-enabled electronic materials for the display industry | | | |
| Series B Convertible Preferred Stock | (M) | 1,294,025 | 970,519 |
| Series C Convertible Preferred Stock | (M) | 1,300,000 | 975,000 |
| Series D Convertible Preferred Stock | (M) | 515,756 | 386,817 |
| | | | 2,332,336 |
| | | | |
| CFX Battery, Inc. (5)(6)(7)(15) -- Developing batteries using nanostructured materials | | | |
| Series A Convertible Preferred Stock | (M) | 2,565,798 | 2,822,378 |

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

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2009
(Unaudited)

| | Method of Valuation (1) | Shares/ Principal | Value |
|---|---|---|---|
| Investments in Non-Controlled Affiliated Companies (2)(14) – 43.9% of net assets at value (cont.) | | | |
| Private Placement Portfolio (Illiquid) – 43.9% of net assets at value (cont.) | | | |
| | | | |
| Crystal IS, Inc. (5)(6) -- Developing single-crystal aluminum nitride substrates for light-emitting diodes | | | |
| Series A Convertible Preferred Stock | (M) | 391,571 | $ 0 |
| Series A-1 Convertible Preferred Stock | (M) | 1,300,376 | 0 |
| Unsecured Convertible Bridge Note (including interest) | (M) | $ 408,573 | 0 |
| Warrants at $0.78 expiring 05/05/13 | ( I ) | 15,231 | 0 |
| Warrants at $0.78 expiring 05/12/13 | ( I ) | 2,350 | 0 |
| Warrants at $0.78 expiring 08/08/13 | ( I ) | 4,396 | 0 |
| | | | 0 |
| | | | |
| CSwitch Corporation (5)(6)(7)(16) -- Developed system-on-a-chip solutions for communications-based platforms | | | |
| Series A-1 Convertible Preferred Stock | (M) | 6,863,118 | 0 |
| Unsecured Convertible Bridge Note (including interest) | (M) | $ 1,766,673 | 0 |
| | | | 0 |
| Ensemble Discovery Corporation (5)(6)(7)(17) -- Developing DNA-Programmed ChemistryTM for the discovery of new classes of therapeutics and bioassays | | | |
| Series B Convertible Preferred Stock | (M) | 1,449,275 | 1,000,000 |
| Unsecured Convertible Bridge Note (including interest) | (M) | $ 250,286 | 271,351 |
| | | | 1,271,351 |
| | | | |
| Innovalight, Inc. (5)(6)(7) -- Developing solar power products enabled by silicon-based nanomaterials | | | |
| Series B Convertible Preferred Stock | (M) | 16,666,666 | 2,969,667 |
| Series C Convertible Preferred Stock | (M) | 5,810,577 | 1,252,984 |
| | | | 4,222,651 |

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, 2009
(Unaudited)

| | Method of Valuation (1) | Shares/ Principal | Value |
|---|---|---|---|
| Investments in Non-Controlled Affiliated Companies (2)(14) – 43.9% of net assets at value (cont.) | | | |
| Private Placement Portfolio (Illiquid) – 43.9% of net assets at value (cont.) | | | |
| Kovio, Inc. (5)(6)(7) -- Developing semiconductor products using printed electronics and thin-film technologies | | | |
| Series C Convertible Preferred Stock | (M) | 2,500,000 | $ 1,920,938 |
| Series D Convertible Preferred Stock | (M) | 800,000 | 614,700 |
| Series E Convertible Preferred Stock | (M) | 1,200,000 | 922,050 |
| Warrants at $1.25 expiring 12/31/12 | ( I ) | 355,880 | 160,858 |
| | | | 3,618,546 |
| Mersana Therapeutics, Inc. (5)(6)(7) -- Developing treatments for cancer based on novel drug delivery polymers | | | |
| Series A Convertible Preferred Stock | (M) | 68,451 | 68,451 |
| Series B Convertible Preferred Stock | (M) | 866,500 | 866,500 |
| Unsecured Convertible Bridge Note (including interest) | (M) | $ 650,000 | 691,780 |
| Warrants at $2.00 expiring 10/21/10 | ( I ) | 91,625 | 21,257 |
| | | | 1,647,988 |
| Metabolon, Inc. (5)(6) -- Developing service and diagnostic products through the use of a metabolomics, or biochemical, profiling platform | | | |
| Series B Convertible Preferred Stock | (M) | 371,739 | 1,034,061 |
| Series B-1 Convertible Preferred Stock | (M) | 148,696 | 413,625 |
| Series C Convertible Preferred Stock | (M) | 1,000,000 | 1,000,000 |
| Warrants at $1.15 expiring 3/25/15 | ( I ) | 74,348 | 115,815 |
| | | | 2,563,501 |
| NanoGram Corporation (5)(6) -- Developing solar power products enabled by silicon-based nanomaterials | | | |
| Series I Convertible Preferred Stock | (M) | 63,210 | 0 |
| Series II Convertible Preferred Stock | (M) | 1,250,904 | 0 |
| Series III Convertible Preferred Stock | (M) | 1,242,144 | 0 |
| Series IV Convertible Preferred Stock | (M) | 432,179 | 0 |
| | | | 0 |

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

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2009
(Unaudited)

| | Method of Valuation (1) | Shares/ Principal | Value |
|---|---|---|---|
| Investments in Non-Controlled Affiliated Companies (2)(14) – 43.9% of net assets at value (cont.) | | | |
| Private Placement Portfolio (Illiquid) – 43.9% of net assets at value (cont.) | | | |
| Nextreme Thermal Solutions, Inc. (5)(6) -- Developing thin-film thermoelectric devices for cooling and energy conversion | | | |
| Series A Convertible Preferred Stock | (M) | 17,500 | $ 1,750,000 |
| Series B Convertible Preferred Stock | (M) | 4,870,244 | 2,655,257 |
| | | | 4,405,257 |
| Questech Corporation (5)(6) -- Manufacturing and marketing proprietary metal and stone decorative tiles | | | |
| Common Stock | (M) | 655,454 | 340,836 |
| Warrants at $1.50 expiring 11/19/09 | ( I ) | 5,000 | 0 |
| | | | 340,836 |
| Solazyme, Inc. (5)(6)(7) -- Developing algal biodiesel, industrial chemicals and special ingredients based on synthetic biology | | | |
| Series A Convertible Preferred Stock | (M) | 988,204 | 4,978,157 |
| Series B Convertible Preferred Stock | (M) | 495,246 | 2,494,841 |
| Series C Convertible Preferred Stock | (M) | 651,309 | 3,281,021 |
| | | | 10,754,019 |
| Xradia, Inc. (5)(6) -- Designing, manufacturing and selling ultra-high resolution 3D x-ray microscopes and fluorescence imaging systems | | | |
| Series D Convertible Preferred Stock | (M) | 3,121,099 | 5,118,602 |
| Total Non-Controlled Private Placement Portfolio (cost: $60,109,424) | | | $ 48,920,403 |
| | | | $ 48,920,403 |

Total Investments in Non-Controlled Affiliated Companies (cost: $60,109,424)

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

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2009
(Unaudited)

| | Method of Valuation (1) | | Shares/ Principal | | Value |
|---|---|---|---|---|---|
| Investments in Controlled Affiliated Companies (2)(18) – 3.6% of net assets at value | | | | | |
| Private Placement Portfolio (Illiquid) – 3.6% of net assets at value | | | | | |
| Laser Light Engines, Inc. (5)(6)(7) -- Manufacturing solid-state light sources for digital cinema and large-venue projection displays | | | | | |
| Series A Convertible Preferred Stock | (M) | | 7,499,062 | $ | 1,000,000 |
| Secured Convertible Bridge Note (including interest) | (M) | $ | 890,000 | | 911,458 |
| | | | | | 1,911,458 |
| SiOnyx, Inc. (5)(6)(7) -- Developing silicon-based optoelectronic products enabled by its proprietary "Black Silicon" | | | | | |
| Series A Convertible Preferred Stock | (M) | | 233,499 | | 67,843 |
| Series A-1 Convertible Preferred Stock | (M) | | 2,966,667 | | 861,965 |
| Series A-2 Convertible Preferred Stock | (M) | | 4,207,537 | | 1,222,500 |
| | | | | | 2,152,308 |
| Total Controlled Private Placement Portfolio (cost: $6,996,458) | | | | $ | 4,063,766 |
| Total Investments in Controlled Affiliated Companies (cost: $6,996,458) | | | | $ | 4,063,766 |
| Total Private Placement and Publicly Traded Portfolio (cost: $93,953,704) | | | | $ | 70,049,615 |

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, 2009
(Unaudited)

| | | Method of Valuation (1) | Shares/ Principal | Value |
|---|---|---|---|---|
| U.S. Government Securities (19) – 60.1% of net assets at value | | | | |
| U.S. Treasury Bill | -- due date 10/01/09 | (M) | $ 25,725,000 | $ 25,725,000 |
| U.S. Treasury Bill | -- due date 12/17/09 | (M) | 11,700,000 | 11,697,894 |
| U.S. Treasury Bill | -- due date 12/24/09 | (M) | 25,725,000 | 25,720,198 |
| U.S. Treasury Notes | -- due date 02/28/10, coupon 2.000% | (M) | 3,800,000 | 3,828,348 |
| Total Investments in U.S. Government Securities (cost: $66,960,793) | | | | $ 66,971,440 |
| Total Investments (cost: $160,914,497) | | | | $ 137,021,055 |

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

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2009
(Unaudited)

Notes to Consolidated Schedule of Investments

(1) See Footnote to Consolidated Schedule of Investments on page 17 for a description of the Valuation Procedures.

(2) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company or less than five percent of the common shares of the publicly traded company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company, or where we hold one or more seats on the portfolio company's Board of Directors but do not control the company. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company or otherwise control the company.

(3) The aggregate cost for federal income tax purposes of investments in unaffiliated private companies is $26,648,390. The gross unrealized appreciation based on the tax cost for these securities is $1,124,915. The gross unrealized depreciation based on the tax cost for these securities is $10,881,264.

(4) The aggregate cost for federal income tax purposes of investments in unaffiliated publicly traded companies is $199,432. 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 $26,027.

(5) Legal restrictions on sale of investment.

(6) Represents a non-income producing security. Equity investments that have not paid dividends within the last 12 months are considered to be non-income producing.

(7) These investments are development stage companies. A development stage company is defined as a company that is devoting substantially all of its efforts to establishing a new business, and either it has not yet commenced its planned principal operations, or it has commenced such operations but has not realized significant revenue from them.

(8) With our purchase of Series E Convertible Preferred Stock of BioVex, we received a warrant to purchase a number of shares of common stock of BioVex as determined by dividing 624,999.99 by the price per share at which the common stock is offered and sold to the public in connection with the initial public offering. The ability to exercise this warrant is therefore contingent on BioVex completing successfully an initial public offering before the expiration date of the warrant on September 27, 2012. The exercise price of this warrant shall be 110 percent of the initial public offering price.

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

HARRIS & HARRIS GROUP, INC.
CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF SEPTEMBER 30, 2009
(Unaudited)

(9) Cobalt Technologies, Inc., does business as Cobalt Biofuels.

(10) D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave Systems, Inc., through D-Wave USA, a Delaware company. Our investment is denominated in Canadian dollars and is subject to foreign currency translation. See "Note 3. Summary of Significant Accounting Policies."

(11) Starfire Systems, Inc., filed for Chapter 11 bankruptcy on August 13, 2009.

(12) With our purchase of the Series B Convertible Preferred Stock of TetraVitae Bioscience, Inc., we received the right to purchase, at a price of $2.63038528 per share, a number of shares in the Series C financing equal to the number of shares of Series B Preferred Stock purchased. The ability to exercise this right is contingent on TetraVitae Bioscience completing successfully a subsequent round of financing.

(13) Initial investment was made during 2009.

(14) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is $60,109,424. The gross unrealized appreciation based on the tax cost for these securities is $10,051,394. The gross unrealized depreciation based on the tax cost for these securities is $21,240,415.

(15) On February 28, 2008, Lifco, Inc., merged with CFX Battery, Inc. The surviving entity is CFX Battery, Inc.

(16) CSwitch Corporation ceased operations in June 2009.

(17) With our investment in a convertible bridge note issued by Ensemble Discovery, we received a warrant to purchase a number of shares of the class of stock sold in the next financing of Ensemble Discovery equal to $125,105.40 divided by the price per share of the class of stock sold in the next financing of Ensemble Discovery. The ability to exercise this warrant is, therefore, contingent on Ensemble Discovery completing successfully a subsequent round of financing. This warrant shall expire and no longer be exercisable on September 10, 2015. The cost basis of this warrant is $75.20.

(18) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is $6,996,458. 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 $2,932,692.

(19) The aggregate cost for federal income tax purposes of our U.S. government securities is $66,960,793. The gross unrealized appreciation on the tax cost for these securities is $10,647. The gross unrealized depreciation on the tax cost of these securities is $0.

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

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

VALUATION PROCEDURES

I. Determination of Net Asset Value

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

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

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

The values assigned to these investments are based on available information and do not necessarily represent amounts that might ultimately be realized, 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

Under accounting principles generally accepted in the United States of America ("GAAP"), fair value is defined 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).

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

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

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

Inputs used to measure fair value by these approaches are classified into the following hierarchy:

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

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

## III. Investment Categories

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

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

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

### A. EQUITY-RELATED SECURITIES

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

- Readily available public market quotations;
- The cost of the Company’s investment;
- Transactions in a company's securities or unconditional firm offers by responsible parties as a factor in determining valuation;
- The financial condition and operating results of the company;
- The company's progress towards milestones;
- The long-term potential of the business and technology of the company;
- The values of similar securities issued by companies in similar businesses;
- Multiples to revenue, net income or EBITDA that similar securities issued by companies in similar businesses receive;
- The proportion of the company's securities we own and the nature of any rights to require the company to register restricted securities under applicable securities laws; and
- The rights and preferences of the class of securities we own as compared to 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 market approach. The factors that may be considered when valuing these types of securities by the market approach include:

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

C. SHORT-TERM FIXED-INCOME SECURITIES

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

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

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

- 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 this Section III.  They do not necessarily represent an amount of money that would be realized if we had to sell such assets and that difference could be material.  Thus, valuations as of any particular date are not necessarily indicative of amounts that we may ultimately realize as a result of future sales or other dispositions of investments we hold.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

## NOTE 1. THE COMPANY

Harris & Harris Group, Inc. (the "Company," "us," "our" and "we"), is a venture capital company operating as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"). We operate as an internally managed company whereby our officers and employees, under the general supervision of our Board of Directors, conduct our operations.

We elected to become a BDC on July 26, 1995, after receiving the necessary shareholder approvals. From September 30, 1992, until the election of BDC status, we operated as a closed-end, non-diversified investment company under the 1940 Act. Upon commencement of operations as an investment company, we revalued all of our assets and liabilities in accordance with the 1940 Act. Prior to September 30, 1992, we were registered and filed under the reporting requirements of the Securities Exchange Act of 1934 (the "1934 Act") as an operating company and, while an operating company, operated directly and through subsidiaries.

Harris & Harris Enterprises, Inc.SM, is a 100 percent wholly owned subsidiary of the Company. Harris & Harris Enterprises, Inc., is a partner in Harris Partners I, L.P. SM, and is taxed under Subchapter C of the Code (a "C Corporation"). Harris Partners I, L.P, is a limited partnership and, from time to time, may be used to hold certain interests in portfolio companies. The partners of Harris Partners I, L.P., are Harris & Harris Enterprises, Inc., (sole general partner) and Harris & Harris Group, Inc. (sole limited partner). Harris & Harris Enterprises, Inc., pays taxes on any non-passive investment income generated by Harris Partners I, L.P. For the period ended September 30, 2009, there was no non-passive investment income generated by Harris Partners I, L.P. The Company consolidates the results of its subsidiaries for financial reporting purposes.

## NOTE 2. INTERIM FINANCIAL STATEMENTS

Our interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and in conformity with accounting principles generally accepted in the United States of America (“GAAP”) applicable to interim financial information. Accordingly, they do not include all information and disclosures necessary for a presentation of our financial position, results of operations and cash flows in conformity with GAAP. In the opinion of management, these financial statements reflect all adjustments, consisting of valuation adjustments and normal recurring accruals, necessary for a fair presentation of our financial position, results of operations and cash flows for such periods. The results of operations for any interim period are not necessarily indicative of the results for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Principles of Consolidation. The consolidated financial statements have been prepared in accordance with GAAP and include the accounts of the Company and its wholly owned subsidiary. All significant inter-company accounts and transactions have been eliminated in consolidation.

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

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

Portfolio Investment Valuations. Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the SEC and in accordance with GAAP. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) the fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments.") At September 30, 2009, our financial statements include private venture capital investments and one publicly traded venture capital investment valued at $69,876,210 and $173,405, respectively. The fair values of our private venture capital investments were determined in good faith by, or under the direction, of the Board of Directors. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. The difference could be material.

On January 1, 2008, the Company adopted guidance issued by the Financial Accounting Standards Board (“FASB”) which requires the Company to assume that the portfolio investment is to be sold in the principal market to market participants, or in the absence of a principal market, the most advantageous market, which may be a hypothetical market.

On October 10, 2008, the FASB issued guidance for determining the fair value of a financial asset when the market for that asset is not active, which reiterated that an entity should utilize its own assumptions, information and techniques to estimate fair value when relevant observable inputs are not available, including the use of risk-adjusted discount factors for non-performance risk or liquidity risk.

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, 2009, included in the net decrease in unrealized depreciation on investments was a $399,892 gain resulting from foreign currency translation.

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

Interest Income Recognition. Interest income, adjusted for amortization of premium and accretion of discount, is recorded on an accrual basis. When securities are determined to be non-income producing, the Company ceases accruing interest and writes off any previously accrued interest. During the three months and nine months ended September 30, 2009, the Company earned $39,625 and $113,213, respectively, in interest on U.S. government securities and interest-bearing accounts. During the three months and nine months ended September 30, 2009, the Company recorded, net of write-offs, $60,052 and $25,649, respectively, of bridge note interest.

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

Stock-Based Compensation. The Company has a stock-based employee compensation plan. The Company accounts for the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan") by determining the fair value of all share-based payments to employees, including the fair value of grants of employee stock options, and record these amounts as an expense in the Statement of Operations over the vesting period with a corresponding increase to our additional paid-in capital. At September 30, 2009, and December 31, 2008, 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 tax benefits associated with the expensing of stock options, because the Company currently intends to qualify as a RIC under Subchapter M of the Code. The amount of non-cash, stock-based compensation expense recognized in the Consolidated Statements of Operations is based on the fair value of the awards the Company expects to vest, recognized over the vesting period on a straight-line basis for each award, and adjusted for actual options vested and pre-vesting forfeitures. The forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if the actual forfeiture rate differs from the estimated rate and is accounted for in the current period and prospectively. See "Note 6. Stock-Based Compensation" for further discussion.

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

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

Restricted Funds. The Company maintained a rabbi trust for the purposes of accumulating funds to satisfy the obligations incurred by us for the Supplemental Executive Retirement Plan ("SERP") under the employment agreement with Charles E. Harris, the former Chairman and Chief Executive Officer of the Company. The final payment from this rabbi trust was made on July 31, 2009, after which the rabbi trust was closed.

Property and Equipment. Property and equipment are included in "Other Assets" and are carried at $82,123 and $119,180 at September 30, 2009, and December 31, 2008, 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 five to seven years for leasehold improvements.

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

Recent Accounting Pronouncements. In April of 2009, the FASB issued guidance for determining fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly. It provides additional guidance for fair value measures in determining if the market for an asset or liability is inactive and, accordingly, if quoted market prices may not be indicative of fair value. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In the second quarter of 2009, the FASB issued guidance extending the existing disclosure requirements related to the fair value of financial instruments, which were previously only required in annual financial statements, to interim periods. This guidance only required additional disclosures and, therefore, its adoption did not have any impact on the Company's consolidated financial statements. These disclosure requirements are included in Note 5 to the consolidated financial statements.

Effective July 1, 2009, the FASB’s Accounting Standards Codification (“ASC” or “Codification”) became the single official source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The FASB will no longer issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts; instead, the FASB will issue Accounting Standards Updates. Accounting Standards Updates will not be authoritative in their own right as they will only serve to update the Codification. These changes and the Codification itself do not change GAAP. Other than the manner in which new accounting guidance is referenced, the adoption of these changes had no impact on the Company’s consolidated financial statements.

NOTE 4. BUSINESS RISKS AND UNCERTAINTIES

We have invested a substantial portion of our assets in private development stage or start-up companies. These private businesses tend to be based on new technology and to be thinly capitalized, unproven, small companies that lack management depth and have not attained profitability or have no history of operations. Because of the speculative nature and the lack of a public market for these investments, there is greater risk of loss than is the case with traditional investment securities.

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

NOTE 5. INVESTMENTS

At September 30, 2009, our financial assets were categorized as follows in the fair value hierarchy:

| | | Fair Value Measurement at Reporting Date Using: | | |
|---|---|---|---|---|
| Description | September 30, 2009 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| U.S. Government Securities | $ 66,971,440 | $ 63,143,092 | $ 3,828,348 | $ 0 |
| Private Portfolio Companies | $ 69,876,210 | $ 0 | $ 0 | $ 69,876,210 |
| Publicly Traded Portfolio Companies | $ 173,405 | $ 173,405 | $ 0 | $ 0 |
| Total | $ 137,021,055 | $ 63,316,497 | $ 3,828,348 | $ 69,876,210 |

The following chart shows the components of change in the financial assets categorized as Level 3, for the three months ended September 30, 2009.

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3)<br>Portfolio Companies |
|---|---|
| Beginning Balance, July 1, 2009 | $ 63,959,811 |
| Total realized losses included in change in net assets | (3,176,125) |
| Total unrealized gains included in change in net assets | 5,151,694 |
| Investments in private placements and interest on bridge notes | 3,944,945 |
| Disposals | (4,115) |
| Ending Balance, September 30, 2009 | $ 69,876,210 |
| The amount of total gains for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to | $ 1,971,454 |

assets still held at the reporting date

The following chart shows the components of change in the financial assets categorized as Level 3, for the nine months ended September 30, 2009.

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) |
|---|---|
| | Portfolio Companies |
| Beginning Balance, January 1, 2009 | $ 56,965,153 |
| Total realized losses included in change in net assets | (4,690,455) |
| Total unrealized gains included in change in net assets | 10,246,786 |
| Purchases and interest on bridge notes | 7,460,429 |
| Disposals and write-offs of bridge note interest | (105,703) |
| Ending Balance, September 30, 2009 | $ 69,876,210 |
| The amount of total gains for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date | $ 5,581,235 |

NOTE 6. STOCK-BASED COMPENSATION

On March 18, 2009, the Compensation Committee of the Board of Directors and the full Board of Directors of the Company approved a grant of individual Non-Qualified Stock Option ("NQSO") awards for certain officers and employees of the Company. The terms and conditions of the stock options granted were set forth in award agreements between the Company and each award recipient entered into on that date. Options to purchase a total of 329,999 shares of stock were granted with vesting periods ranging from March 2010 to March 2013 and with an exercise price of $3.75, which was the closing price of our shares of common stock as quoted on the Nasdaq Global Market on March 18, 2009. The awards were to become fully vested and exercisable prior to the date or dates in the vesting schedule if (1) the market price of the shares of our stock reaches $6 per share at the close of business on three consecutive trading days on the Nasdaq Global Market or (2) the Board of Directors accepts an offer for the sale of substantially all of the Company's assets.

At the close of business on July 28, 2009, the price of our stock reached $6.00 for the third consecutive trading day on the Nasdaq Global Market. Pursuant to the terms of the stock options granted on March 18, 2009, the vesting schedule accelerated and all 329,999 options became immediately vested and exercisable. The remaining compensation cost of $364,839 was recognized in the quarter ended September 30, 2009. This expense has no impact on the net asset value as the non-cash compensation cost is offset by an increase to our additional paid-in capital.

On May 13, 2009, the Compensation Committee of the Board of Directors and the full Board of Directors of the Company approved a grant of individual NQSO awards for certain officers and employees of the Company. The terms and conditions of the stock options granted were set forth in award agreements between the Company and each award recipient entered into on that date. Options to purchase a total of 200,000 shares of stock were granted with vesting periods ranging from November 2009 to May 2013 and with an exercise price of $4.46, which was the closing price of our shares of common stock as quoted on the Nasdaq Global Market on May 13, 2009. The awards may become fully vested and exercisable prior to the date or dates in the vesting schedule if the Board of Directors accepts an offer for the sale of substantially all of the Company's assets. Upon exercise, the shares would be issued from our previously authorized but unissued shares.

The fair value of the options was determined on the date of grant using the Black-Scholes-Merton or lattice models based on the following factors.

An option's expected term is the estimated period between the grant date and the exercise date of the option. As the expected term period increases, the fair value of the option and the non-cash compensation cost will also increase. The expected term assumption is generally calculated using historical stock option exercise data. Management has performed an analysis and has determined that historical exercise data does not provide a sufficient basis to calculate the expected term of the option. In cases where companies do not have historical data and where the options meet certain criteria, SEC Staff Accounting Bulletin 107 ("SAB 107") provides the use of a simplified expected term calculation. Accordingly, the Company calculated the expected term used in the Black-Scholes-Merton model using the SAB 107 simplified method.

Expected volatility is the measure of how the stock's price is expected to fluctuate over a period of time. An increase in the expected volatility assumption yields a higher fair value of the stock option. The expected volatility factor for the Black-Scholes-Merton and lattice models were based on the historical fluctuations in the Company’s stock price over a period commensurate with the expected term and contractual term, respectively, of the options, adjusted for stock splits and dividends.

The expected exercise factor in the lattice model is an estimate of when options will be exercised when they are in the money. An expected exercise factor of two assumes that options will be exercised when they reach two times their strike price.

The expected dividend yield assumption is traditionally calculated based on a company's historical dividend yield. An increase to the expected dividend yield results in a decrease in the fair value of options and resulting compensation cost. Although the Company has declared deemed dividends in previous years, most recently in 2005, the amounts and timing of any future dividends cannot be reasonably estimated. Therefore, for purposes of calculating fair value, the Company has assumed an expected dividend yield of zero percent.

The risk-free interest rate assumption used in the Black-Scholes-Merton model is based on the annual yield on the measurement date of a zero-coupon U.S. Treasury bond the maturity of which equals the option’s expected term. The lattice model uses interest rates commensurate with the contractual term of the options. Higher assumed interest rates yield higher fair values.

The assumptions used in the calculation of fair value of the two-year NQSOs granted on March 18, 2009, using the Black-Scholes-Merton model for the expected term was as follows:

| Type of Award | Term | Number of Options Granted | Expected Term in Yrs | Expected Volatility Factor | Expected Dividend Yield | Risk-free Interest Rates | Weighted Average Fair Value Per Share |
|---|---|---|---|---|---|---|---|
| Non-qualified stock options | 2 Years | 245,770 | 1.5 | 71.7% | 0% | 0.71% | $1.29 |
| Total | | 245,770 | | | | | $1.29 |

The assumptions used in the calculation of fair value of the 10-year NQSOs granted on March 18, 2009, using a binomial lattice model for the contract term was as follows:

| Type of Award | Term | Number of Options Granted | Expected Exercise Behavior Factor | Expected Volatility Factor | Expected Dividend Yield | Risk-free Interest Rates | Weighted Average Fair Value Per Share |
|---|---|---|---|---|---|---|---|
| Non-qualified stock options | 10 Years | 84,229 | 2 | 73.1% | 0% | 2.59% | $1.97 |
| Total | | 84,229 | | | | | $1.97 |

The assumptions used in the calculation of fair value of the two-year and 10-year NQSOs granted on May 13, 2009, using the Black-Scholes-Merton model for the expected term was as follows:

| Type of Award | Term | Number of Options Granted | Expected Term in Yrs | Expected Volatility Factor | Expected Dividend Yield | Risk-free Interest Rates | Weighted Average Fair Value Per Share |
|---|---|---|---|---|---|---|---|
| Non-qualified stock options | 2 Years | 148,800 | 1.375 | 105.5% | 0% | 0.52% | $2.08 |
| Non-qualified stock options | 10 Years | 51,200 | 6.25 | 60.6% | 0% | 2.35% | $2.60 |
| | | 200,000 | | | | | $2.21 |

For the three months and nine months ended September 30, 2009, the Company recognized $1,013,608 and $2,425,525, respectively, of compensation expense in the Consolidated Statements of Operations. As of September

30, 2009, there was approximately $6,075,320 of unrecognized compensation cost related to unvested stock option awards.  This cost is expected to be recognized over a weighted average period of approximately two years.

For the three months and nine months ended September 30, 2009, a total of 107,185 options were exercised for total proceeds to the Company of $401,944.

For the three and nine months ended September 30, 2009, the calculation of net decrease in net assets resulting from operations per share excludes the stock options because such options were anti-dilutive. Stock options may be dilutive in future periods in which there is a net increase in net assets resulting from operations, in the event that there is a significant increase in the average stock price in the stock market or significant decreases in the amount of unrecognized compensation cost.

A summary of the changes in outstanding stock options for the nine months ended September 30, 2009, is as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Grant Date Fair Value | Weighted Average Remaining Contractual Term (Yrs) | Aggregate Intrinsic Value |
|---|---|---|---|---|---|
| Options Outstanding at January 1, 2009 | 4,638,213 | $ 9.30 | $ 4.83 | 6.03 | $ 0 |
| Granted | 529,999 | $ 4.02 | $ 1.75 | 3.57 | |
| Exercised | 107,185 | $ 3.75 | $ 1.29 | | |
| Forfeited or Expired | 479,460 | $10.11 | $ 3.81 | | |
| Options Outstanding at September 30, 2009 | 4,581,567 | $ 8.73 | $ 4.66 | 5.75 | $ 939,310 |
| Options Exercisable at September 30, 2009 | 2,626,608 | $ 9.27 | $ 4.86 | 5.38 | $ 563,104 |
| Options Exercisable and Expected to be Exercisable at September 30, 2009 | 4,522,466 | $ 8.71 | $ 4.63 | 5.74 | $ 939,310 |

The aggregate intrinsic value in the table above with respect to options outstanding, exercisable and expected to be exercisable, is calculated as the difference between the Company's closing stock price of $6.25 on the last trading day of the third quarter of 2009 and the exercise price, multiplied by the number of in-the-money options. This amount represents the total pre-tax intrinsic value that would have been received by the option holders had all options been fully vested and all option holders exercised their awards on September 30, 2009.

NOTE 7. INCOME TAXES

For the nine months ended September 30, 2009, we recorded a benefit of $753 in federal, state and local income taxes. During the third quarter of 2009, we recorded a benefit of $2,862 in federal, state and local income taxes. At September 30, 2009, we had $0 accrued for federal, state and local taxes payable by the Company.

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We pay federal, state and local taxes on behalf of our wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is taxed as a C Corporation. For the three months ended September 30, 2009, and 2008, our income tax (benefit) expense for Harris & Harris Enterprises, Inc., was $(2,960) and $0, respectively. For the nine months ended September 30, 2009, and 2008, our income tax (benefit) expense for Harris & Harris Enterprises, Inc., was $(2,960) and $31,068, respectively.

NOTE 8. CAPITAL TRANSACTIONS

On June 20, 2008, we completed the sale of 2,545,000 shares of our common stock for gross proceeds of $15,651,750; net proceeds of this offering, after placement agent fees and offering costs of $1,268,253, were $14,383,497.

On July 24, 2009, we filed a shelf Registration Statement on Form N-2 with the SEC to register an additional 7,000,000 shares of our common stock. This Registration Statement was declared effective on September 22, 2009, and the sale of 4,887,500 of these shares was completed on October 9, 2009. We filed to deregister the 2,112,500 unused shares on October 26, 2009. See Note 11 “Subsequent Events.”

NOTE 9. CHANGE IN NET ASSETS PER SHARE

The following table sets forth the computation of basic and diluted per share net decreases in net assets resulting from operations for the three months and nine months ended September 30, 2009, and September 30, 2008.

| | For the Three Months Ended September 30 | | For the Nine Months Ended September 30 | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Numerator for decrease in net assets per share | $(296,319) | $(34,032,747) | $(826,376) | $(35,967,073) |
| Denominator for basic and diluted weighted average shares | 25,866,983 | 25,859,573 | 25,862,070 | 24,271,270 |
| Basic and diluted net decrease in net assets per share resulting from operations | $(0.01) | $(1.32) | $(0.03) | $(1.48) |

NOTE 10. EMPLOYEE BENEFITS

We established a rabbi trust for the purpose of accumulating funds to satisfy the obligations incurred by us under the SERP, which amounted to $0 and $188,454 at September 30, 2009, and December 31, 2008, respectively, and is included in accounts payable and accrued liabilities. The restricted funds for the SERP Account totaled $0 and $188,454 at September 30, 2009, and December 31, 2008, respectively. Mr. Harris's rights to benefits pursuant to this SERP were no greater than those of a general creditor of us.

Mr. Harris received a distribution from his SERP Account totaling $2,889,717 during 2008. On July 31, 2009, the balance of $189,383 was paid to Mr. Harris, and the rabbi trust was closed.

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NOTE 11. SUBSEQUENT EVENTS

On October 1, 2009, we made a $721,090 follow-on investment in a privately held tiny technology portfolio company.

On October 9, 2009, we closed a public follow-on offering of 4,887,500 shares of our common stock at a price of $4.75 per share to the public. The net proceeds of this offering, after deducting underwriting discounts and offering costs of $1,937,931, were $21,277,694.

On October 13, 2009, we made a $100,000 follow-on investment in a privately held tiny technology portfolio company.

On October 22, 2009, we made a $1,000,000 follow-on investment in a privately held tiny technology portfolio company.

On October 26, 2009, we filed a post-effective amendment to our shelf registration statement on Form N-2 to deregister 2,112,500 shares of common stock that were not sold in the public offering that closed on October 9, 2009.

On November 2, 2009, we made a $108,383 follow-on investment in a privately held tiny technology portfolio company.

On November 3, 2009, we made a $299,145 follow-on investment in a privately held tiny technology portfolio company.

On November 4, 2009, the Compensation Committee resolved to award bonuses to employees totaling $294,000 payable on December 15, 2009.

We have evaluated subsequent events through November 6, 2009, which represents the issuance date of the financial statements.

NOTE 12. COMMITMENTS

On September 24, 2009, we entered into a lease agreement for approximately 6,900 square feet of office space located at 1450 Broadway, New York, New York. The lease will commence on the later of January 1, 2010, or when the leasehold improvements are completed. We plan to use the office space to replace our current offices in New York City, which serve as our corporate headquarters.

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. The lease expires on December 31, 2019.

We have one option to extend the lease term for a five-year period, provided that we are not in default under the lease. Annual rent during the renewal period will equal 95 percent of the fair market value of the leased premises, as determined in accordance with the lease.

Upon an event of default, the lease provides that the landlord may terminate the lease and require us to pay all rent that would have been payable during the remainder of the lease or until the date the landlord re-enters the premises.

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

| | Three Months Ended Sept. 30 | | Nine Months Ended Sept. 30 | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Per Share Operating Performance | | | | |
| Net asset value per share, beginning of period | $ 4.27 | $ 5.95 | $ 4.24 | $ 5.93 |
| | | | | |
| Net operating (loss)* | (0.08) | (0.09) | (0.25) | (0.30) |
| Net realized (loss) on investments*(1) | (0.12) | (0.17) | (0.18) | (0.36) |
| Net decrease in unrealized depreciation as a result of sales*(1) | 0.12 | 0.17 | 0.18 | 0.41 |
| Net decrease (increase) in unrealized depreciation on investments held* | 0.07 | (1.23) | 0.21 | (1.17) |
| Total from investment operations* | (0.01) | (1.32) | (0.04) | (1.42) |
| | | | | |
| Net increase as a result of stock-based compensation expense* | 0.03 | 0.05 | 0.09 | 0.18 |
| Decrease as a result of stock-offering, net of offering expenses | 0.00 | 0.00 | 0.00 | (0.01) |
| Net increase as a result of proceeds from exercise of options | 0.01 | 0.00 | 0.01 | 0.00 |
| Total increase from capital stock transactions | 0.04 | 0.05 | 0.10 | 0.17 |
| | | | | |
| Net asset value per share, end of period | $ 4.30 | $ 4.68 | $ 4.30 | $ 4.68 |
| Stock price per share, end of period | $ 6.25 | $ 6.38 | $ 6.25 | $ 6.38 |
| Total return based on stock price (2) | 7.20% | 6.33% | 58.23% | (27.42)% |
| | | | | |
| Supplemental Data: | | | | |
| | | | | |
| Net assets, end of period | $ 111,532,206 | $ 121,113,660 | $ 111,532,206 | $ 121,113,660 |
| | | | | |
| Ratio of expenses to average net assets (2) | 2.1% | 2.0% | 5.9% | 6.5% |
| | | | | |
| Ratio of net operating loss to average net assets (2) | (2.0)% | (1.6)% | (5.8)% | (5.3)% |
| | | | | |
| Cash dividend paid per share | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 |
| | | | | |
| Deemed dividend per share | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 |
| | | | | |
| Number of shares outstanding, end of period | 25,966,758 | 25,859,573 | 25,966,758 | 25,859,573 |

*Based on Average Shares Outstanding

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

description of realized and unrealized gains and losses.
(2) Not annualized

The accompanying notes are an integral part of this schedule.

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

The information contained in this section should be read in conjunction with the Company's unaudited September 30, 2009, Consolidated Financial Statements and the Company's audited 2008 Consolidated Financial Statements and notes thereto.

Background and Overview

We incorporated under the laws of the state of New York in August 1981. In 1983, we completed an initial public offering. 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 business development company subject to the provisions of Sections 55 through 65 of the 1940 Act.

We are a venture capital company that specializes in making investments in companies commercializing and integrating products enabled by nanotechnology and microsystems. Nanotechnology is the study of structures measured in nanometers, which are units of measurement in billionths of a meter. Microsystems are measured in micrometers, which are units of measurement in millionths of a meter. We sometimes use "tiny technology" to describe both of these disciplines.

We consider a company to fit our investment thesis if the company employs or intends to employ technology that we consider to be at the microscale or smaller and if the employment of that technology is material to its business plan. We define venture capital investments as the money and resources made available to privately held start-up firms and privately held and publicly traded small businesses with exceptional growth potential. By making these investments, we seek to provide our shareholders with a specific focus on nanotechnology and microsystems through a portfolio of venture capital investments that address a variety of markets and products.

We believe that we are the only publicly traded business development company making venture capital investments exclusively in nanotechnology and microsystems. We believe we provide three core benefits to our shareholders. First, we are an established firm with a track record of investing in venture capital-backed companies. Second, we provide shareholders with access to emerging companies that commercialize and integrate products enabled by nanotechnology and microsystems that are generally privately owned. Third, we provide access to venture capital investments in a vehicle that, unlike private venture capital firms, is both transparent and liquid.

We have discretion in the investment of our capital. Primarily, we invest in illiquid equity securities. Generally, these investments take the form of preferred stock, are subject to restrictions on resale and have no established trading market. Throughout our corporate history, we have made primarily early stage venture capital investments in a variety of industries. These businesses can range in stage from pre-revenue to cash flow positive. The businesses in which we invest tend to be thinly capitalized, unproven, small companies that lack management depth, have little or no history of operations and are developing unproven technologies. We may also make follow-on investments in any of our portfolio companies.

At September 30, 2009, $69,876,210, or 62.7 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of $23,878,062. At December 31, 2008, $56,965,153, or 52.0 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of $34,124,848.

Historical Investment Track Record

Since our investment in Otisville in 1983 through September 30, 2009, we have made a total of 85 venture capital investments, including four private placement investments in securities of publicly traded companies. We have exited 53 of these 85 investments, realizing total proceeds of $143,930,719 on our invested capital of $65,454,819. As measured from first dollar in to last dollar out, the average and median holding periods for these 53 investments were 3.9 years and 3.3 years, respectively. As measured by the 180 separate rounds of investment within these 53 investments, the average and median holding periods for the 180 separate rounds of investment were 2.9 years and 2.6 years, respectively.

In 1994, we invested in our first nanotechnology company, Nanophase Technologies Corporation. Recognizing the potential of nanotechnology, we continued to monitor developments in the field, and since 2001, we have made nanotechnology and microsystems the exclusive focus of our initial investment activity. From August 2001 through September 30, 2009, all 43 of our initial investments have been in companies commercializing or integrating products enabled by nanotechnology or microsystems. From August 2001 through September 30, 2009, we have invested a total (before any subsequent write-ups, write-downs or dispositions) of $111,950,586 in these companies.

Age of Current Portfolio and Investment Pace

We currently have 30 active tiny technology companies in our portfolio, including one investment made prior to 2001. At September 30, 2009, from first dollar in, the average and median holding periods for these 30 active tiny technology investments were 4.3 years and 3.7 years, respectively.

| Tiny Technology Companies in Our Active Portfolio as of September 30, 2009 | Holding Period (Years) |
|---|---|
| Adesto Technologies Corporation | 2.6 |
| Ancora Pharmaceuticals Inc. | 2.4 |
| BioVex Group, Inc. | 2.0 |
| BridgeLux, Inc. (formerly eLite Optoelectronics, Inc.) | 4.4 |
| Cambrios Technologies Corporation | 4.9 |
| CFX Battery, Inc. (formerly Lifco, Inc.) | 2.3 |
| Cobalt Technologies, Inc. | 1.0 |
| Crystal IS, Inc. | 5.0 |
| D-Wave Systems, Inc. | 3.5 |
| Ensemble Discovery Corporation | 2.3 |

| | |
|---|---|
| Innovalight, Inc. | 3.4 |
| Kovio, Inc. | 3.9 |

| | |
|---|---|
| Laser Light Engines, Inc. | 1.4 |
| Mersana Therapeutics, Inc. (formerly Nanopharma Corporation) | 7.6 |
| Metabolon, Inc. | 3.7 |
| Molecular Imprints, Inc. | 5.5 |
| NanoGram Corporation | 6.4 |
| Nanosys, Inc. | 6.5 |
| Nantero, Inc. | 8.2 |
| NeoPhotonics Corporation 2004 | 5.8 |
| Nextreme Thermal Solutions, Inc. | 4.8 |
| Orthovita, Inc. | 0.1 |
| Polatis, Inc. (formerly Continuum Photonics, Inc.) | 7.3 |
| PolyRemedy, Inc. | 1.6 |
| Questech Corporation (formerly Intaglio, Ltd.) | 15.4 |
| Siluria Technologies, Inc. | 2.0 |
| SiOnyx, Inc. | 3.4 |
| Solazyme, Inc. | 4.9 |
| TetraVitae Bioscience, Inc. | 1.0 |
| Xradia, Inc. | 2.8 |
| Average | 4.3 |
| Median | 3.7 |

Our cumulative dollars invested in nanotechnology and microsystems increased from $489,999 for the year ended December 31, 2001, to $111,950,586 through September 30, 2009. The following is a summary of our initial and follow-on investments in nanotechnology from January 1, 2005, to September 30, 2009. We consider a "round led" to be a round where we were the new investor or the leader of a set of investors in an investee company. Typically, but not always, the lead investor negotiates the price and terms of a deal with the investee company.

| | 2005 | 2006 | 2007 | 2008 | Nine Months Ended Sept. 30, 2009 |
|---|---|---|---|---|---|
| Total Incremental Investments | $16,251,339 | $24,408,187 | $20,595,161 | $17,779,462 | $7,535,874 |
| No. of New Investments | 4 | 6 | 7 | 4 | 1 |
| No. of Follow-On Investment Rounds | 13 | 14 | 20 | 25 | 18 |

| | | | | | |
|---|---|---|---|---|---|
| No. of Rounds Led | 0 | 7 | 3 | 4 | 3 |
| Average Dollar Amount – Initial | $1,575,000 | $2,383,424 | $1,086,441 | $683,625 | $99,624 |
| Average Dollar Amount – Follow-On | $765,488 | $721,974 | $649,504 | $601,799 | $413,125 |

Commercialization of Nanotechnology by Our Portfolio Companies

Our nanotechnology investments have matured around three main industry clusters: cleantech (42.3 percent of our venture capital portfolio as of September 30, 2009); electronics, including semiconductors (34.4 percent of our venture capital portfolio as of September 30, 2009); and healthcare/biotechnology (10.2 percent of our venture capital portfolio as of September 30, 2009). We call these three areas "Nanotech for CleantechSM," "Nanotech for ElectronicsSM," and "Nanotech for HealthcareSM," respectively. We have and may continue to make investments outside these industry areas, and we may not maintain these industry clusters or the weightings within these clusters.

These three clusters are multi-billion dollar industries that have grown historically through technological innovation. "Cleantech" is a term used commonly to describe products and processes that solve global problems related to resource constraints. We classify Nanotech for CleantechSM 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 believe nanotechnology will impact cleantech solutions in at least two ways. First, nanotechnology-enabled methods of production can allow lower energy use at lower cost and operate with better performance than current methods of production. Second, new materials enable the development of new products that overcome inherent limitations of existing technology and processes.

We classify Nanotech for ElectronicsSM companies as those that use nanotechnology to address problems in electronics-related industries, including semiconductors. We believe nanotechnology will impact these industries in at least four ways. First, nanotechnology enables reduced manufacturing cost and increased performance of semiconductor and electronics systems as the density of components increases. Second, new capabilities of semiconductor and electronic products are made possible by nanoscale materials. Third, nanotechnology offers differentiation and improved performance that allows nanotechnology-enabled electronics companies to capture value in a market often characterized by outsourced manufacturing and a commodity production process. Fourth, novel methods of computing, such as quantum computing, may be enabled by nanoscale phenomenon.

We classify Nanotech for HealthcareSM companies as those that use nanotechnology to address problems in healthcare-related industries, including biotechnology, pharmaceuticals and medical devices. We believe nanotechnology will impact these industries in at least two ways. First, we believe the ability to study, optimize, and design biological pathways at the nanoscale enables the manipulation and engineering of biological systems for diagnosis and treatment of disease. Second, we believe new tools are necessary to provide critical insights into what is happening at the nanoscale to enhance and enable advances in healthcare technology.

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

Maturity of Current Venture Capital Portfolio

Our active venture capital portfolio comprises companies at stages of maturity that fall into three categories defined by us: 1) Pre-Revenue / Pre-Clinical, 2) Initial Revenue / Phase I/II Clinical Trials and 3) Expansion Stage / Phase III Clinical Trials. Pre-Revenue / Pre-Clinical companies are those that have a high degree of technical, market and execution risk (which is typical of initial investments by venture capital firms, including us). Initial Revenue / Phase I Clinical Trials companies are those that have overcome most of the technical risk associated with their products and are now focused on addressing the market risk for their products. For those companies developing therapeutics or medical devices, the focus is on bringing their products through the first phases of clinical trials. Expansion Stage / Phase III Clinical Trials companies are those that have determined there is a market for their products, and they are now focused on sales execution and supply of their products to the market. Phase III Clinical Trials are the pivotal trials before a possible FDA approval and commercial launch of a product. The chart below shows our assessment of the stage of maturity of our 30 active portfolio companies.

As our portfolio companies progress through these stages of maturity, they are penetrating high-growth, billion-dollar markets where nanotechnology enables significant advances. These companies offer a range of products including components for optical networking, high-brightness LEDs, imaging devices for security and surveillance, printable electronics, nano-imprint lithography equipment, X-ray imaging equipment, optical switches, solid-state cooling, metabolomic profiling services, synthetic carbohydrates and decorative tiles.  We currently have 16 companies in our active portfolio that generate commercial revenue from the sale of products or services enabled by nanotechnology and microsystems.

Current Business Environment

The banking, global stock market and commodity price collapses, and the slowdown in global economic activities that began with the intensification of the housing and credit crises during the third quarter of 2008, remained as significant influences on the economy in general as of the end of the third quarter of 2009.  Although there were a few positive events during the third quarter of 2009, such as the successful initial public offerings ("IPOs") of A123 Systems, Inc., and OpenTable, Inc., and the second positive quarter in a row for the U.S. public stock markets, the availability of capital for venture capital firms and venture capital-backed companies continues to be extremely tight.  This conclusion is supported in part by the fact that according to Dow Jones VentureSource, venture capital investment in the United States during the third quarter of 2009 was down approximately six percent from the second quarter of 2009.  This source states further that if the current trend of investment by venture capital firms continues through the remainder of the year, the total amount of investment in 2009 could fall below $20 billion for the first time since 1998.

Even though the public markets increased in value during the third quarter of 2009, the global economic recession continues to affect the ability of investors to exit investments in privately held companies. Merger and acquisition activity in the third quarter was similar to that of 1999, with only 71 venture-backed companies acquired, according to Dow Jones VentureSource. Two venture-backed companies completed IPOs during the third quarter of 2009, compared with three in the second quarter of 2009, which brings the total number of IPOs to five for 2009. Overall, the total amount realized from liquidity events of venture-backed companies was down 49 percent from $5.32 billion in the third quarter of 2008 to $2.70 billion in the most recent quarter. These data support our belief that the increases in the value of publicly traded companies do not necessarily correspond with the ability of investors to exit privately held companies. As such, we expect that it may take significantly more time for the liquidity market for venture capital-backed companies to recover from the current economic turmoil than the public stock markets. We continue to believe this lack of liquidity will negatively affect the amount of capital available to privately held companies from venture capital firms.

For new and follow-on investments, we generally syndicate with other venture capital firms and corporate investors. We plan to continue this approach, while taking into account that the current economic turmoil has affected the availability of capital to our potential co-investors, particularly firms that manage a small amount of assets. This fact may reduce the number of potential co-investors available to us when forming syndicates. The inability to form a syndicate of investors may decrease the number of investments made by us in both new and current portfolio companies.

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

Many venture capital firms, including us, are evaluating their investment portfolios carefully to assess future potential capital needs. In the current business climate, this evaluation may result in a decrease in the number of companies we decide to finance going forward or may increase the number of companies we decide to sell before reaching their full potential. Our ownership in portfolio companies that we decide to stop funding may be subject to punitive actions that reduce or eliminate value. Such actions could result in an unprofitable investment or a complete loss of invested funds. If we decide to proceed with a follow-on investment, these rounds of financing may occur at valuations lower than those at which we invested originally.

We continue to view the current economic climate and the disruption in the venture capital industry as both a concern and an opportunity. Through the first nine months of 2009, our aim was to preserve our cash and manage our current operating expenses to enable us to make follow-on investments in current portfolio companies and to look for new investment opportunities as we monitored the state of the capital markets. During the first nine months of 2009, we invested $99,624 in one new investment, and we invested $7,436,250 in 18 follow-on investments. This pace compares with two new and 19 follow-on investments totaling $2,244,500 and $12,390,685, respectively, in the first nine months of 2008.

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

Valuation of Investments

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

Publicly traded companies, one of the most observable asset classes, continued to increase in value broadly during the third quarter of 2009 from lows reached during the first quarter of 2009. These values, including the market value of Harris & Harris Group, remain below those before the economic collapse. The table below compares these changes in value during the past three quarters and from the 52-week high of each index and of Harris & Harris Group:

| | Q1 2009<br>12/31/08 - 3/31/09 | Q2 2009<br>3/31/09 - 6/30/09 | Q3 2009<br>6/30/09 – 9/30/09 | 52-Week High as of 9/30/09 |
|---|---|---|---|---|
| Dow Jones Industrial Avg. | -13.3% | 11.0% | 15.0% | -11.7% |
| Nasdaq Composite | -3.07% | 20.0% | 15.7% | -1.1% |
| S&P 500 Composite | -11.67% | 15.2% | 15.0% | -10.3% |
| Russell 2000 | -15.36% | 20.2% | 18.9% | -12.5% |
| Harris & Harris Group | -6.33% | 57.6% | 7.2% | -8.0% |

The values of privately held, venture capital-backed companies are inherently more difficult to assess at any single point in time because securities of these types of companies are not actively traded. We continue to believe that the substantial drop or increase in value of publicly traded companies is an indicator of the decrease or increase of values of privately held, venture capital-backed companies, but we do not believe it applies on a one-for-one basis.

As part of the valuation process, we consider non-performance risk as the risk that a portfolio company will be: (a) unable to raise capital, will need to be shut down and will not return our invested capital; or (b) able to raise capital, but at a valuation significantly lower than the implied post-money valuation. Our best estimate of the non-performance risk of our portfolio companies has been quantified and included in the valuation of the companies as of September 30, 2009. In the future, as these companies receive terms for additional financings or are unable to receive additional financing and, therefore, proceed with sales or shutdowns of the business, we expect the contribution of the discount for non-performance risk to vary in importance in determining the values of these companies.

In each of the years in the period 2005 through 2008, and for the nine months ended September 30, 2009, the Company recorded the following gross write-ups in privately held securities as a percentage of net assets at the beginning of the year ("BOY"), gross write-downs in privately held securities as a percentage of net assets at the beginning of the year, and net write-ups/(write-downs) in portfolio securities as a percentage of net assets at the beginning of the year.

| | 2005 | 2006 | 2007 | 2008 | Nine Months Ended Sept. 30, 2009 |
|---|---|---|---|---|---|
| Net Asset Value, BOY | $74,744,799 | $117,987,742 | $113,930,303 | $138,363,344 | $109,531,113 |
| Gross Write-Downs During Year | $(3,450,236) | $(4,211,323) | $(7,810,794) | $(39,671,588) | $(11,251,660) |
| Gross Write-Ups During Year | $23,485,176 | $279,363 | $11,694,618 | $820,559 | $16,806,868 |
| Gross Write-Downs as a Percentage of Net Asset Value, BOY | -4.62% | -3.57% | -6.86% | -28.67% | -10.2% |
| Gross Write-Ups as a Percentage of Net Asset Value, BOY | 31.42% | 0.24% | 10.26% | 0.59% | 15.3% |
| Net Write-Downs/Write-Ups as a Percentage of Net Asset Value, BOY | 26.8% | -3.33% | 3.40% | -28.08% | 5.1% |

For the nine months ended September 30, 2009, we recorded gross write-downs of $11,251,660. These write-downs primarily reflect our assessment of the non-performance risk associated with our portfolio companies in the current business environment. This non-performance risk discount accounted for the majority of the $11,251,660 in gross write-downs. The remaining write-downs reflected adjustments of valuations relating to specific fundamental developments unique to particular portfolio companies.

For the nine months ended September 30, 2009, we recorded gross write-ups of $16,806,868. These write-ups were primarily owing to adjustments of valuations relating to specific fundamental developments unique to particular portfolio companies. For Solazyme, Inc., Nextreme Thermal Solutions, Inc., Adesto Technologies, Inc., Bridgelux, Inc., Xradia, Inc., and Molecular Imprints, Inc., gross write-ups of $12,075,947 related to fundamental developments, including financing events during the first nine months of 2009. For NeoPhotonics, Inc., the gross write-up of $2,094,325 resulted from the increase in the average market capitalization as a multiple of revenue of a set of publicly traded companies with comparable businesses.

The increase or decrease in the value of our venture capital investments does not affect the day-to-day operations of the Company, as we have no debt and fund our venture capital investments and daily operating expenses from interest earned and proceeds from the sales of our investments in U.S. government and agency obligations. As of September 30, 2009, we held $66,971,440 in U.S. government obligations, of which $25,720,198 was an unsettled treasury trade that was paid for on October 1, 2009.

Investment Objective

Our principal objective is to achieve long-term capital appreciation, rather than current income, by making venture capital investments. We seek to reach the point where future growth is financed through reinvestment of our capital gains from these investments. Therefore, a significant portion of our investment portfolio provides little or no income in the form of dividends or interest. We earn interest income from fixed-income securities, including U.S. government and agency securities. The amount of interest income we earn varies with the average balance of our fixed-income portfolio and the average yield on this portfolio. Interest income is secondary to capital gains and losses in our results of operations.

In previous years, we have been able to generate substantial amounts of interest income from our holdings of U.S. treasury securities. As of September 30, 2009, we held four short-duration U.S. treasury securities yielding approximately 0.3 percent. As of September 30, 2009, yields for 3-month, 6-month, and 12-month U.S. treasury securities were 0.14 percent, 0.18 percent and 0.40 percent, respectively. As of September 30, 2008, yields for 3-month, 6-month, and 12-month U.S. treasury securities were 0.92 percent, 1.60 percent and 1.78 percent, respectively. With yields at this level, we expect to generate less interest income than in previous fiscal quarters and years.

Results of Operations

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

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

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

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

Owing to the structure and objectives of our business, we generally expect to experience net operating losses and seek to generate increases in our net assets from operations through the long term appreciation of our venture capital investments. We have relied, and continue to rely, on proceeds from sales of investments, rather than on investment income, to defray a significant portion of our operating expenses. Because such sales are unpredictable, we attempt to maintain adequate working capital to provide for fiscal periods when there are no such sales.

Three months ended September 30, 2009, as compared to the three months ended September 30, 2008

In the three months ended September 30, 2009, and September 30, 2008, we had net decreases in net assets resulting from operations of $296,319 and $34,032,747, respectively.

Investment Income and Expenses:

We had net operating losses of $2,242,953 and $2,196,739 for the three months ended September 30, 2009, and September 30, 2008, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expenses of $1,013,608 in 2009 and $1,367,567 in 2008 associated with the granting of stock options. During the three months ended September 30, 2009, and 2008, total investment income was $105,677 and $587,918, respectively. During the three months ended September 30, 2009, and 2008, total operating expenses were $2,348,630 and $2,784,657, respectively.

During the three months ended September 30, 2009, as compared with the same period in 2008, investment income decreased, primarily reflecting a substantial decrease in interest rates, as well as a decrease in our average holdings of U.S. government securities. The average yield on our U.S. government securities decreased from 3.6 percent for the three months ended September 30, 2008, to 0.3 percent for the three months ended September 30, 2009. During the three months ended September 30, 2009, our average holdings of such securities were $49,590,199, as compared with $58,057,162 during the three months ended September 30, 2008.

Operating expenses, including non-cash, stock-based compensation expense, were $2,348,630 and $2,784,657 for the three months ended September 30, 2009, and September 30, 2008, respectively. The decrease in operating expenses for the three months ended September 30, 2009, as compared to the three months ended September 30, 2008, was primarily owing to decreases in salaries, benefits and stock-based compensation expense and to a decrease in administration and operations expense, offset by increases in professional fees and custodian fees. Salaries, benefits and stock-based compensation expense decreased by $478,237, or 21.7 percent, through September 30, 2009, as compared to September 30, 2008, primarily as a result of a decrease in non-cash expense of $353,959 associated with the Stock Plan and a decrease in salaries and benefits owing primarily to a decrease in our headcount, including the retirement of Charles E. Harris. At September 30, 2009, we had 11 full-time employees, as compared with 12 full-time employees at September 30, 2008. While the non-cash, stock-based compensation expense for the Stock Plan increased our operating expenses by $1,013,608, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our net asset value. The non-cash, stock-based compensation expense and corresponding increase to our additional paid-in capital may increase in future quarters. Administration and operations expense decreased by $27,840, or 11.0 percent, through September 30, 2009, as compared to September 30, 2008, primarily as a result of a decrease in our directors' and officers' liability insurance expense and decreases in the cost of non-employee related insurance and managing directors' travel-related expenses. Professional fees increased by $52,481, or 37.9 percent, for the three months ended September 30, 2009, as compared with the same period in 2008, primarily as a result of an increase in certain legal, consulting and accounting fees. Custodian fees increased by $19,306, or 135.9 percent, compared with the same period in 2008. This increase is owing to the higher fees charged by our new custodian who has more expertise in working with investment companies.

Realized Income and Losses from Investments:

During the three months ended September 30, 2009, and September 30, 2008, we realized net losses on investments of $3,176,125 and $4,373,124, respectively.

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

During the three months ended September 30, 2008, we realized net losses of $4,373,124, consisting primarily of realized losses on Evolved Nanomaterial Sciences, Inc., of $2,800,000, on Phoenix Molecular Corporation of $93,487 and on Zia Laser, Inc., of $1,478,500.

Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the three months ended September 30, 2009, net unrealized depreciation on total investments decreased by $5,119,897, or 17.6 percent, from net unrealized depreciation of $29,013,339 at June 30, 2009, to net unrealized depreciation of $23,893,442 at September 30, 2009. During the three months ended September 30, 2008, net unrealized depreciation on total investments increased by $27,460,782, or 636.3 percent, from net unrealized appreciation of $4,315,915 at June 30, 2008, to net unrealized depreciation of $23,144,867 at September 30, 2008.

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

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

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

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

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

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

During the three months ended September 30, 2008, net unrealized depreciation on our venture capital investments increased by $27,847,181, from net unrealized appreciation of $3,875,764 at June 30, 2008, to net unrealized depreciation of $23,971,417 at September 30, 2008, owing primarily to decreases in the valuations of the following investments held, offset by an increase in the valuation of Questech Corporation of $54,693:

| Investment | Amount of Write-Down |
|---|---|
| Adesto Technologies Corporation | $1,100,000 |
| Ancora Pharmaceuticals, Inc. | 400,000 |
| BioVex Group, Inc. | 1,250,000 |
| BridgeLux, Inc. | 983 |
| Cambrios Technologies Corporation | 1,297,012 |
| Crystal IS, Inc. | 997,401 |
| CSwitch Corporation | 4,519,350 |
| D-Wave Systems, Inc. | 8,397 |
| Ensemble Discovery Corporation | 1,000,000 |
| Exponential Business Development Company | 168 |
| Innovalight, Inc. | 1,927,946 |
| Kereos, Inc. | 90,371 |
| Mersana Therapeutics, Inc. | 1,006,602 |
| Metabolon, Inc. | 1,395,874 |
| Molecular Imprints, Inc. | 2,296,178 |
| NanoGram Corporation | 2,943,611 |
| Nanomix, Inc. | 691,090 |
| Neophotonics Corporation | 2,364,458 |
| Nextreme Thermal Solutions, Inc. | 2,182,233 |
| Polatis, Inc. | 276,526 |
| PolyRemedy, Inc. | 122,250 |
| Siluria Technologies, Inc. | 120,542 |
| Solazyme, Inc. | 5,378,325 |
| Starfire Systems, Inc. | 690,000 |

We also had decreases in unrealized depreciation attributable to the reversal of unrealized depreciation owing to realization of net losses on Evolved Nanomaterial Sciences, Inc., of $2,800,000 and on Zia Laser, Inc., of $1,478,500. We had a decrease owing to foreign currency translation of $121,057 on our investment in D-Wave Systems, Inc. Unrealized appreciation on our U.S. government securities portfolio increased from $440,151 at June 30, 2008, to $826,550 at September 30, 2008.

Nine months ended September 30, 2009, as compared with the Nine months ended September 30, 2008

In the nine months ended September 30, 2009, and September 30, 2008, we had net decreases in net assets resulting from operations of $826,376 and $35,967,073, respectively.

Investment Income and Expenses:

We had net operating losses of $6,340,103 and $7,315,640 for the nine months ended September 30, 2009, and September 30, 2008, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expenses of $2,425,525 in 2009 and $4,333,892 in 2008 associated with the granting of stock options. During the nine months ended September 30, 2009, and 2008, total investment income was $165,950 and $1,631,845, respectively. During the nine months ended September 30, 2009, and 2008, total operating expenses were $6,506,053 and $8,947,485, respectively.

During the nine months ended September 30, 2009, as compared with the same period in 2008, investment income decreased, reflecting a substantial decrease in interest rates, as well as a decrease in our average holdings of U.S. government securities. The average yield on our U.S. government securities decreased from 3.7 percent for the nine months ended September 30, 2008, to 0.3 percent for the nine months ended September 30, 2009. During the nine months ended September 30, 2009, our average holdings of such securities were $50,447,538, as compared with $56,089,836 at September 30, 2008.

Operating expenses, including non-cash, stock-based compensation expense, were $6,506,053 and $8,947,485 for the nine months ended September 30, 2009, and September 30, 2008, respectively. The decrease in operating expenses for the nine months ended September 30, 2009, as compared with the nine months ended September 30, 2008, was primarily owing to decreases in salaries, benefits and stock-based compensation expense and to decreases in administration and operations expense and directors' fees and expenses, offset by increases in professional fees, rent expense and custodian fees. Salaries, benefits and stock-based compensation expense decreased by $2,479,397, or 34.9 percent, through September 30, 2009, as compared to September 30, 2008, primarily as a result of a decrease in non-cash expense of $1,908,367 associated with the Stock Plan and a decrease in salaries and benefits owing primarily to a decrease in our headcount, including the retirement of Charles E. Harris. At September 30, 2009, we had 11 full-time employees, as compared with 12 full-time employees at September 30, 2008. While the non-cash, stock-based compensation expense for the Stock Plan increased our operating expenses by $2,425,525, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our net asset value. The non-cash, stock-based compensation expense and corresponding increase to our additional paid-in capital may increase in future quarters. Administration and operations expense decreased by $91,460, or 10.9 percent, through September 30, 2009, as compared to September 30, 2008, primarily as a result of a decrease in our directors' and officers' liability insurance expense, decreases in the cost of non-employee related insurance and decreases in travel-related expenses. Professional fees increased by $79,924, or 16.7 percent, for the nine months ended September 30, 2009, as compared with the same period in 2008, primarily as a result of an increase in certain accounting and legal fees, offset by a reduction in the cost of our annual compliance program audit and a reduction in certain consulting fees.

Rent expense increased by $38,718, or 19.6 percent, primarily as a result of the rent associated with our Palo Alto office lease. We sublet portions of this office and include the rental income in miscellaneous income. Custodian fees increased by $24,552, or 91.3 percent, compared to the same period in 2008. This increase is owing to the higher fees charged by our new custodian who has more expertise in working with investment companies.

Realized Income and Losses from Investments:

During the nine months ended September 30, 2009, we realized net losses on investments of $4,690,780, as compared with realized net losses on investments of $9,384,082 during the nine months ended September 30, 2008.

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

During the nine months ended September 30, 2008, we realized net losses of $9,384,082, consisting primarily of realized losses on our investments in Chlorogen, Inc., of $1,326,072, in Evolved Nanomaterial Sciences, Inc., of $2,800,000, in NanoOpto Corporation of $3,688,581, in Phoenix Molecular Corporation of $93,487 and in Zia Laser of $1,478,500. During the nine months ended September 30, 2008, we received a payment of $105,714 from the NanoOpto Corporation bridge note.

Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the nine months ended September 30, 2009, net unrealized depreciation on total investments decreased by $10,203,754, or 29.9 percent, from net unrealized depreciation of $34,097,196 at December 31, 2008, to net unrealized depreciation of $23,893,442 at September 30, 2009. During the nine months ended September 30, 2008, net unrealized depreciation on total investments increased by $19,218,383, or 489.5 percent, from net unrealized depreciation of $3,926,484 at December 31, 2007, to net unrealized depreciation of $23,144,867 at September 30, 2008.

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

| Investment | Amount of Write-Up |
|---|---|
| Adesto Technologies Corporation | $1,320,000 |
| BioVex Group, Inc. | 331,246 |
| BridgeLux, Inc. | 995,124 |
| Cambrios Technologies Corporation | 519,567 |
| CFX Battery, Inc. | 812,383 |
| Metabolon, Inc. | 200,235 |
| Molecular Imprints, Inc. | 1,062,605 |
| NeoPhotonics Corporation | 2,094,325 |
| Nextreme Thermal Solutions, Inc. | 2,202,628 |
| Questech Corporation | 212,550 |
| Siluria Technologies, Inc. | 160,723 |
| Solazyme, Inc. | 5,376,988 |
| Xradia, Inc. | 1,118,602 |

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

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

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

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

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

During the nine months ended September 30, 2008, net unrealized depreciation on our venture capital investments increased by $19,404,273, from net unrealized depreciation of $4,567,144 at December 31, 2007, to net unrealized depreciation of $23,971,417 at September 30, 2008, owing primarily to decreases in the valuations of the following investments held:

| Investment | Amount of Write-Down |
|---|---|
| Adesto Technologies Corporation | $1,100,000 |
| Ancora Pharmaceuticals, Inc. | 299,439 |
| BioVex Group, Inc. | 1,250,000 |
| BridgeLux, Inc. | 2,721 |
| Cambrios Technologies Corporation | 1,297,012 |
| Crystal IS, Inc. | 997,796 |
| CSwitch Corporation | 4,519,350 |
| Ensemble Discovery Corporation | 1,000,000 |
| Innovalight, Inc. | 1,927,946 |
| Kereos, Inc. | 159,743 |
| Mersana Therapeutics, Inc. | 1,015,673 |
| Metabolon, Inc. | 2,132,386 |
| Molecular Imprints, Inc. | 2,468,095 |
| NanoGram Corporation | 2,943,611 |
| Nanomix, Inc. | 980,418 |
| Neophotonics Corporation | 3,401,952 |
| Nextreme Thermal Solutions, Inc. | 2,182,133 |
| Polatis, Inc. | 276,526 |
| PolyRemedy, Inc. | 122,250 |
| Questech Corporation | 398,283 |
| Siluria Technologies, Inc. | 120,542 |
| Starfire Systems, Inc. | 750,000 |

We also had decreases in unrealized depreciation attributable to the reversal of depreciation owing to net realized losses on Chlorogen, Inc., of $1,326,072, on Evolved Nanomaterial Sciences, Inc., of $2,800,000, on NanoOpto Corporation of $3,688,581 and on Zia Laser, Inc., of $1,478,672. For the nine months ended September 30, 2008, we had increases in the valuations of our investments in D-Wave Systems, Inc., of $5,199, Exponential Business Development Company of $25 and Solazyme, Inc., of $821,340. We had a decrease owing to foreign currency translation of $178,286 on our investment in D-Wave Systems, Inc. Unrealized appreciation on our U.S. government securities portfolio increased from $640,660 at December 31, 2007, to $826,550 at September 30, 2008.

Financial Condition

September 30, 2009

At September 30, 2009, our total assets and net assets were $139,136,433 and $111,532,206, respectively. At December 31, 2008, they were $111,627,601 and $109,531,113, respectively.

At September 30, 2009, net asset value per share was $4.30, as compared with $4.24 at December 31, 2008. At September 30, 2009, our shares outstanding increased to 25,966,758 from 25,859,573.

Significant developments in the nine months ended September 30, 2009, included an increase in the holdings of our venture capital investments and U.S. government obligations of $13,084,462 and $13,987,500, respectively. The increase in the value of our venture capital investments from $56,965,153 at December 31, 2008, to $70,049,615 at September 30, 2009, resulted primarily from an increase in the net value of our venture capital investments of $10,220,759 and from one new and eighteen follow-on investments of $7,535,874, offset by realized losses on disposals of $4,690,780. The increase in the value of our U.S. government obligations from $52,983,940 at December 31, 2008, to $66,971,440 at September 30, 2009, is primarily owing to temporary timing differences resulting from the purchase of U.S. government securities prior to the end of the third quarter of $25,720,198, with payment for such purchase due in the fourth quarter, offset by the payment of cash basis operating expenses of $3,911,992 and follow-on venture capital investments totaling $7,535,874.

The following table is a summary of additions to our portfolio of venture capital investments made during the nine months ended September 30, 2009:

| New Investments | Amount of Investment |
|---|---|
| Orthovita, Inc. | $ 99,624 |

| Follow-On Investments | Amount of Investment |
|---|---|
| Adesto Technologies Corp. | $ 550,000 |
| Adesto Technologies Corp. | 1,635,775 |
| Ancora Pharmaceuticals Inc. | 125,000 |
| Ancora Pharmaceuticals Inc. | 200,000 |
| BioVex Group, Inc. | 111,111 |
| BioVex Group, Inc. | 166,667 |
| BridgeLux, Inc. | 250,124 |
| Cambrios Technologies Corporation | 515,756 |
| CFX Battery, Inc. | 3,492 |
| CFX Battery, Inc. | 533,239 |
| Cobalt Technologies, Inc. | 374,999 |
| Crystal IS, Inc. | 408,573 |
| Laser Light Engines, Inc. | 890,000 |
| Mersana Therapeutics, Inc. | 200,000 |
| Mersana Therapeutics, Inc. | 250,000 |
| Metabolon, Inc. | 1,000,000 |
| Orthovita, Inc. | 99,808 |
| PolyRemedy, Inc. | 121,706 |
| | |
| Total | $ 7,535,874 |

The following tables summarize the values of our portfolios of venture capital investments and U.S. government obligations, as compared with their cost, at September 30, 2009, and December 31, 2008:

| | Sept. 30, 2009 | December 31, 2008 |
|---|---|---|
| Venture capital investments, at cost | $ 93,953,704 | $ 91,090,001 |
| Net unrealized depreciation(1) | 23,904,089 | 34,124,848 |
| Venture capital investments, at value | $ 70,049,615 | $ 56,965,153 |

| | Sept. 30, 2009 | December 31, 2008 |
|---|---|---|
| U.S. government obligations, at cost | $ 66,960,793 | $ 52,956,288 |
| Net unrealized appreciation(1) | 10,647 | 27,652 |
| U.S. government obligations, at value | $ 66,971,440 | $ 52,983,940 |

(1)At September 30, 2009, and December 31, 2008, the net accumulated unrealized depreciation on investments was $23,893,442 and $34,097,196, respectively.

Liquidity

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

We fund our day-to-day operations using interest earned and proceeds from the sales of our investments in U.S. government securities. The increase or decrease in the valuations of our portfolio companies does not impact our daily liquidity. At September 30, 2009, and December 31, 2008, we had no investments in money market mutual funds. We have no debt outstanding, and, therefore, are not subject to credit agency downgrades.

At September 30, 2009, and December 31, 2008, our total net primary liquidity was $42,947,494 and $53,701,819, respectively. The decrease in our primary liquidity from December 31, 2008, to September 30, 2009, is primarily owing to the use of funds for investments and payment of net operating expenses.

We believe that the market disruption that began in September of 2008 and continued during the third quarter of 2009 may continue to adversely affect financial services companies with respect to the valuation of their investment portfolios, tighter lending standards and reduced access to capital. In addition, the economies of the United States and many other countries are in recession. These conditions may lead to a further decline in net asset value and/or decline in valuations of our portfolio companies. Although we cannot predict future market conditions, we continue to believe that our current cash and U.S. government security holdings and our ability to adjust our investment pace will provide us with adequate liquidity to execute our current business strategy.

Except for a rights offering, we are also generally not able to issue and sell our common stock at a price below our net asset value per share, exclusive of any distributing commission or discount, without shareholder approval. As of September 30, 2009, our net asset value was $4.30 per share and our closing market price was $6.25 per share. We do not currently have shareholder approval to issue or sell shares below our net asset value per share.

Capital Resources

On June 20, 2008, we completed the sale of 2,545,000 shares of our common stock, for total gross proceeds of $15,651,750; net proceeds of this offering, after placement agent fees and offering costs of $1,268,253, were $14,383,497. We have used all of the net proceeds of this offering to make new investments in nanotechnology, as well as for follow-on investments in our existing venture capital investments and for working capital.

Critical Accounting Policies

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

Valuation of Portfolio Investments

The most significant estimate inherent in the preparation of our consolidated financial statements is the valuation of investments and the related amounts of unrealized appreciation and depreciation of investments recorded. As a BDC, we invest in primarily illiquid securities that generally have no established trading market.

Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the SEC. 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, 2009, our financial statements include private venture capital investments valued at $69,876,210, the fair values of which were determined in good faith by, or under the direction of, the Board of Directors. As of September 30, 2009, approximately 62.7 percent of our net assets represent investments in portfolio companies valued at fair value by the Board of Directors.

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

The ongoing financial markets turmoil and severe recession have made it extremely difficult for many companies to raise capital. Moreover, the cost of capital has increased substantially. Historically, difficult venture capital environments have resulted in weak companies not receiving financing and being subsequently closed down with a loss of investment to venture investors, and/or strong companies receiving financing but at significantly lower valuations than the preceding venture rounds, leading to very deep dilution for those who do not participate in the new rounds of investment. This economic and financing environment has caused an increase in the non-performance risk for venture capital-backed companies. Our best estimate of the non-performance risk of our portfolio companies has been quantified and included in the valuation of the companies at September 30, 2009.

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

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

At September 30, 2009, all of our private portfolio investments were classified as Level 3 in the hierarchy, indicating a high level of judgment required in their valuation.

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

Stock-Based Compensation

Determining the appropriate fair-value model and calculating the fair value of share-based awards on the date of grant requires judgment. Historically, we have used the Black-Scholes-Merton option pricing model to estimate the fair value of employee stock options. During the quarter ended March 31, 2009, we used the Black-Scholes-Merton option pricing model and a binomial lattice option pricing model to estimate the fair value of the two-year NQSOs and the ten-year NQSOs, respectively, granted on March, 18, 2009. During the quarter ended June 30, 2009, we used the Black-Scholes-Merton option pricing model to estimate the fair value of the two-year and the ten-year NQSOs granted on May 13, 2009.

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

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

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

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

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

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

Pension and Post-Retirement Benefit Plan Assumptions

The Company provides a Retiree Medical Benefit Plan for employees who meet certain eligibility requirements. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability values related to our post-retirement benefit plans. These factors include assumptions we make about the discount rate, the rate of increase in healthcare costs, and mortality, among others.

The discount rate reflects the current rate at which the post-retirement benefit liabilities could be effectively settled considering the timing of expected payments for plan participants. In estimating this rate, we consider rates of return on high quality fixed-income investments included in published bond indexes. We consider the Citigroup Pension Liability Index in the determination of the appropriate discount rate assumptions. The weighted average rate we utilized to measure our post retirement medical benefit obligation as of December 31, 2008, and to calculate our 2009 expense was 5.71 percent, which is a decrease from the 6.55 percent rate used in determining the 2008 expense. We used a discount rate of 5.75 percent to calculate our pension obligation.

Recent Developments — Portfolio Companies

On October 1, 2009, we made a $721,090 follow-on investment in a privately held tiny technology portfolio company.

On October 13, 2009, we made a $100,000 follow-on investment in a privately held tiny technology portfolio company.

On October 22, 2009, we made a $1,000,000 follow-on investment in a privately held tiny technology portfolio company.

On November 2, 2009, we made a $108,383 follow-on investment in a privately held tiny technology portfolio company.

On November 3, 2009, we made a $299,145 follow-on investment in a privately held tiny technology portfolio company.

Recent Developments — Other

On October 9, 2009, we closed a public follow-on offering of 4,887,500 shares of our common stock at a price of $4.75 per share to the public. The net proceeds of this offering, after deducting underwriting discounts and offering costs of $1,937,931, were $21,277,694.

On October 26, 2009, we filed a post-effective amendment to our shelf registration statement on Form N-2 to deregister 2,112,500 shares of common stock that were not sold in the public offering that closed on October 9, 2009.

On November 4, 2009, the Compensation Committee resolved to award bonuses to employees totaling $294,000 payable on December 15, 2009.

Forward-Looking Statements

The information contained herein may contain "forward-looking statements" based on our current expectations, assumptions and estimates about us and our industry. These forward-looking statements involve risks and uncertainties. Words such as "believe," "anticipate," "estimate," "expect," "intend," "plan," "will," "may," "might," "could," "continue" and other similar expressions identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of several factors more fully described in "Risk Factors" and elsewhere in this Form 10-Q, and in our Form 10-K for the year ended December 31, 2008. The forward-looking statements made in this Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Neither our investments nor an investment in us is intended to constitute a balanced investment program. We have invested a substantial portion of our assets in private development stage or start-up companies. These private businesses tend to be based on new technology and to be thinly capitalized, unproven, small companies that lack management depth and have not attained profitability or have no history of operations. Because of the speculative nature and the lack of a public market for these investments, there is significantly greater risk of loss than is the case with traditional investment securities. We expect that some of our venture capital investments will be a complete loss or will be unprofitable and that some will appear to be likely to become successful but never realize their potential. Even when our private equity investments complete initial public offerings, we are normally subject to lock-up agreements for a period of time, and thereafter, the market for the unseasoned publicly traded securities may be relatively illiquid.

Because there is typically no public market for our interests in the small privately held companies in which we invest, the valuation of the equity interests in that portion of our portfolio is determined in good faith by our Valuation Committee, comprised of the independent members of our Board of Directors, in accordance with our Valuation Procedures. In the absence of a readily ascertainable market value, the determined value of our portfolio of equity interests may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests existed. Any changes in valuation are recorded in our consolidated statements of operations as "Net decrease (increase) in unrealized depreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

Investments in privately held, early stage companies are inherently more volatile than investments in more mature businesses. Such immature businesses are inherently fragile and easily affected by both internal and external forces. Our investee companies can lose much or all of their value suddenly in response to an internal or external adverse event. Conversely, these immature businesses can gain suddenly in value in response to an internal or external positive development. During the nine months ended September 30, 2009, we recorded gross write-downs of \$11,251,750. These write-downs are primarily owing to the non-performance risk associated with our portfolio companies in the current economic environment and secondarily to adjustments of valuation to reflect specific fundamental developments unique to particular portfolio companies.

We generally also invest in both short and long-term U.S. government and agency securities. To the extent that we invest in short and long-term U.S. government and agency securities, changes in interest rates result in changes in the value of these obligations that result in an increase or decrease of our net asset value. The level of interest rate risk exposure at any given point in time depends on the market environment, the expectations of future price and market movements, and the quantity and duration of long-term U.S. government and agency securities held by the Company, and it will vary from period to period. If the average interest rate on U.S. government securities with three-month maturities which corresponds to the maturities of the Company's holdings at September 30, 2009, were to increase by 25, 75 and 150 basis points, the average value of these securities held by us at September 30, 2009, would decrease by approximately \$9,500, \$28,500 and \$57,000, respectively, and our net asset value would decrease correspondingly.

Most of our investments are denominated in U.S. dollars. We currently have one investment denominated in Canadian dollars. We are exposed to foreign currency risk related to potential changes in foreign currency exchange rates. The potential loss in fair value on this investment resulting from a 10 percent adverse change in quoted foreign currency exchange rates is \$303,213 at September 30, 2009.

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

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures. As of the end of the period covered by this report, the Company’s management, under the supervision and with the participation of our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as required by Rules 13a-15 of the 1934 Act). Disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the 1934 Act is recorded, processed, summarized and reported, within time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the issuer's management, as appropriate, to allow timely decisions regarding required disclosures. As of September 30, 2009, based upon this evaluation of our disclosure controls and procedures, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective.

(b) Changes in Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the 1934 Act) during the third quarter of 2009 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1A. Risk Factors

Investing in our common stock involves significant risks relating to our business and investment objective. You should carefully consider the risks and uncertainties described in our Annual Report on Form 10-K for the year ended December 31, 2008, before you purchase any of our common stock.

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

Our Nanotech for CleantechSM and Nanotech for ElectronicsSM portfolios are currently the largest portion of our venture capital portfolio, and, therefore, fluctuations in the value of the companies in these portfolios may adversely affect our net asset value per share to a greater degree than other sectors of our portfolio.

The two largest portions of our portfolio are our Nanotech for CleantechSM and Nanotech for ElectronicsSM portfolios. Our Nanotech for CleantechSM portfolio consists of companies commercializing nanotechnology-enabled products targeted at cleantech-related markets. There are risks in investing in companies that target cleantech-related markets, including the rapid and sometimes dramatic price fluctuations of commodities, particularly oil, and of public equities, the reliance on the capital and debt markets to finance large capital outlays and the dependence on government subsidies to be cost-competitive with non-cleantech solutions. For example, the attractiveness of alternative methods for the production of biobutanol and biodiesel can be adversely affected by a decrease in the demand or price of oil. The demand for solar cells is driven partly by government subsidies and the availability of credit to finance the purchase and installation of the system. Adverse developments in any of these sectors may significantly affect the value of our Nanotech for CleantechSM portfolio, and thus our venture capital portfolio as a whole. Additionally, companies with alternative energy (cleantech) platforms are currently in favor with the media and investors. Cleantech companies in general may have a harder time accessing capital in the future if this level of interest subsides.

Our Nanotech for ElectronicsSM portfolio consists of companies commercializing and integrating nanotechnology-enabled products targeted at electronics-related markets. There are risks in investing in companies that target electronics-related markets, including rapid and sometimes dramatic price erosion of products, the reliance on capital and debt markets to finance large capital outlays, including fabrication facilities and inherent cyclicality of the electronics market in general. Additionally, electronics-related companies are currently out of favor with many venture capital firms. Therefore, access to capital may be difficult or impossible for companies in our portfolio that are pursuing these markets.

Our Nanotech for HealthcareSM portfolio companies are subject to several risks which may adversely affect the value of our Nanotech for HealthcareSM portfolio.

Our Nanotech for HealthcareSM portfolio consists of companies that commercialize and integrate products enabled by nanotechnology and microsystems in healthcare-related industries, including biotechnology, pharmaceuticals, diagnostics and medical devices. There are risks in investing in companies that target healthcare-related industries, including but not limited to the uncertainty of timing and results of clinical trials to demonstrate the safety and efficacy of products; failure to obtain any required regulatory approval of products; failure to develop manufacturing processes that meet regulatory standards; competition, in particular from companies that develop rival products; and the ability to protect proprietary technology. Adverse developments in any of these areas at our Nanotech for HealthcareSM portfolio companies may adversely affect the value of our Nanotech for HealthcareSM portfolio.

The three main industry clusters around which our nanotechnology investments have developed are all capital intensive.

The industry clusters where nanotechnology and microsystems are gaining the greatest traction, cleantech, electronics and healthcare, are all capital intensive. In some successful companies, we believe we may need to invest more than we currently have planned to invest in these companies. There can be no assurance that we will have the capital necessary to make such investments. In addition, investing greater than planned amounts in our portfolio companies could limit our ability to pursue new investments and fund follow-on investments. Both of these situations could cause us to miss investment opportunities or limit our ability to protect existing investments from dilution or other actions or events that would decrease the value and potential return from these investments.

Our portfolio companies may incur debt that ranks senior to our investments in such companies.

We sometimes make investments in our portfolio companies in the form of bridge notes that typically convert into preferred stock issued in the next round of financing of that portfolio company. The portfolio companies usually have, or may be permitted to incur, other debt that ranks senior to the debt securities in which we invest. By their terms, debt instruments may provide that the holders are entitled to receive payment of interest and principal on or before the dates on which we are entitled to receive payments in respect of the debt securities in which we invest. Also, in the case of insolvency, liquidation, dissolution, reorganization or bankruptcy of a portfolio company, holders of debt instruments ranking senior to our investment in that portfolio company would typically be entitled to receive payment in full before we receive any distribution in respect of our investment. After repaying such senior creditors, such portfolio company may not have any remaining assets to use for repaying its obligations to us. In addition, in companies where we have made investments in the form of bridge notes, we may also have investments in equity in the form of preferred shares. In such a case, a bankruptcy court may subordinate our bridge notes to debt holders that do not have equity in the portfolio company.

Loss of status as a regulated investment company could reduce our net asset value and distributable income.

We have elected to qualify, qualified and intend to continue to qualify as a regulated investment company under the Code. As a regulated investment company, we do not have to pay federal income taxes on our income (including realized gains) that is distributed to our shareholders. Accordingly, we are not permitted under accounting rules to establish reserves for taxes on our unrealized capital gains. If we failed to qualify for regulated investment company status in 2009 or beyond, we would be taxed in the same manner as an ordinary corporation and distributions to our shareholders would not be deductible in computing our taxable income, which would materially adversely impact the amount of cash available for distribution to our shareholders. In addition, to the extent that we had unrealized gains, we would have to establish reserves for taxes, which would reduce our net asset value, accordingly. To qualify again to be taxed as a regulated investment company in a subsequent year, we would be required to distribute to our shareholders our earnings and profits attributable to non-regulated investment company years reduced by an interest charge of 50 percent of such earnings and profits payable by us to the IRS. In addition, if we failed to qualify as a regulated investment company for a period greater than two taxable years, then, in order to qualify as a regulated investment company in a subsequent year, we would be required to elect to recognize and pay tax on any net built-in gain (the excess of aggregate gain, including items of income, over aggregate loss that would have been realized if we had sold our property to an unrelated party for fair market value) or, alternatively, be subject to taxation on such built-in gain recognized for a period of 10 years. In addition, if we, as a regulated investment company, were to decide to make a deemed distribution of realized net capital gains and retain the net realized capital gains, we would have to establish appropriate reserves for taxes that we would have to pay on behalf of shareholders. It is possible that establishing reserves for taxes could have a material adverse effect on the value of our common stock.

Future sales of our common stock in the public market could cause our stock price to fall.

Sales of a substantial number of shares of our common stock in the public market, or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities.

Item 6. Exhibits

| | |
|---|---|
| 31.01* | Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.02* | Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32* | Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 10.1 | Lease Agreement, dated September 24, 2009, between Rosh 1450 Properties LLC and Harris & Harris Group, Inc., incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on September 24, 2009. |

*filed herewith

SIGNATURES

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

Harris & Harris Group, Inc.

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

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

Date: November 6, 2009

EXHIBIT INDEX

| Exhibit No. | Description |
|---|---|
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