

HARRIS & HARRIS GROUP INC /NY/  
 Form 497  
 June 18, 2007

**Filed Pursuant to Rule 497(e)  
 Registration No. 333-138996**

**PROSPECTUS SUPPLEMENT  
 (To Prospectus dated May 11, 2007)**

**1,300,000**

**Common Stock**

Pursuant to this Prospectus Supplement and the accompanying Prospectus, we are offering 1,300,000 shares of our common stock, par value \$0.01 ("Common Stock"). We are offering the Common Stock on a best efforts basis primarily to institutional investors. We have retained Global Crown Capital, LLC to act as our exclusive placement agent in connection with this offering. See "Plan of Distribution" beginning on page S-20 of this Prospectus Supplement for more information regarding this arrangement.

Our Common Stock is listed on the Nasdaq Global Market under the symbol "TINY." On June 15, 2007, the last reported sale price of our Common Stock on the Nasdaq Global Market was \$11.95 per share.

This Prospectus Supplement does not constitute an offer to sell or a solicitation of an offer to buy the shares offered hereby in any jurisdiction where, or to any person to whom, it is unlawful to make such offer or solicitation.

**Investing in our Common Stock involves risks. See "Risk Factor" on page S-3 of this Prospectus Supplement and "Risk Factors" on page 11 of the accompanying Prospectus.**

	Per Share	Total
Public offering price	\$ 10.79 <sup>(1)</sup>	\$ 14,027,000
Placement agent's fees	\$ 0.65	\$ 841,620
Proceeds, before expenses, to the Company	\$ 10.14	\$ 13,185,380

<sup>(1)</sup> Determined by the 10-day volume-weighted average price (VWAP) minus five percent.

We estimate the total expenses of this offering, excluding the placement agent's fee, will be approximately \$124,500. Because there is no minimum offering amount required as a condition to closing in this offering, the actual public offering amount, placement agent's fee and net proceeds to us, if any, in this offering are not presently determinable and may be substantially less than the maximum offering amounts set forth above. The placement agent is not required to sell a minimum number or dollar amount of shares but will use its best efforts to sell the shares offered. We expect that delivery of the Common Stock being offered pursuant to this Prospectus Supplement will be made to purchasers on or about June 20, 2007. Certain purchaser funds will be deposited into an escrow account and held until jointly released by us and the placement agent on the date the shares are to be delivered to the purchasers. All funds received will be held in a non-interest bearing account.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this Prospectus Supplement is truthful or complete. Any**

**representation to the contrary is a criminal offense.**

The date of this Prospectus Supplement is June 15, 2007.

**Global Crown Capital, LLC  
Placement Agent**

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This Prospectus Supplement dated June 15, 2007, and the accompanying Prospectus dated May 11, 2007, are part of a registration statement on Form N-2 (File No. 333-138996) we filed with the Securities and Exchange Commission using a "shelf" registration process. Under this "shelf" registration process, we may from time to time sell any combination of securities described in the accompanying prospectus in one or more offerings up to a total of 4,000,000 shares.

These documents contain important information you should consider when making your investment decision. The accompanying Prospectus provides you with a general description of the securities we may offer. This Prospectus Supplement contains information about the shares issued in this offering. This Prospectus Supplement may add, update or change information in the accompanying Prospectus. You should rely only on the information provided in this Prospectus Supplement, the accompanying Prospectus or incorporated by reference in this Prospectus Supplement or the accompanying Prospectus. We have not authorized anyone to provide you with any other information. The information contained in the Prospectus and the Prospectus Supplement is accurate only as of the date of the Prospectus and the Prospectus Supplement, regardless of the time of delivery of this Prospectus Supplement or of any sale of the shares.

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## THE OFFERING

Common Stock offered by us pursuant to this supplement	Up to 1,300,000
Shares outstanding after the offering	Up to 23,106,896 <sup>1</sup>
Use of proceeds	We estimate that our net proceeds from this offering after expenses will be approximately \$13,060,880. We intend to use these net proceeds as set forth in "Use of Proceeds" below.
Nasdaq Global Market Symbol	TINY

<sup>(1)</sup> The number of shares of our Common Stock to be outstanding excludes:

- options to purchase approximately 2,907,732 shares of Common Stock at an exercise price of \$10.11 outstanding as of June 15, 2007; and
- approximately 192,986 additional shares of Common Stock reserved for issuance under our equity incentive plans as of June 15, 2007.

## BUSINESS

We are a venture capital company specializing in tiny technology. We were incorporated as a New York corporation in 1981. In 1995, we elected to be regulated as a business development company under the 1940 Act. Our investment objective is to achieve long-term capital appreciation, rather than current income, by making venture capital investments in early-stage companies. Although our portfolio includes insignificant non-tiny technology investments made prior to 2001, we now make our initial investments exclusively in tiny technology companies. By making these investments, we seek to provide our shareholders with a specific focus on tiny technology 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 initial venture capital investments exclusively in tiny technology.

Nanotechnology, microsystems and microelectromechanical systems (MEMS), are often referred to collectively as "tiny technology," or "small technology," by scientists and others in this field. Nanotechnology in particular is multidisciplinary and widely applicable, and it incorporates technology that is significantly smaller than is currently in widespread commercial use. Microsystems are measured in micrometers, which are units of measurement in millionths of a meter. Nanotechnology is measured in nanometers, which are units of measurement in billionths of a meter. Because it is a new field, tiny technology, and particularly nanotechnology, has significant scientific, engineering, regulatory and commercialization risks.

Tiny technology, particularly nanotechnology, is distinguished by its applicability to a wide range of industries. As a venture capital company, we make it possible, through the ownership of our shares, for our shareholders to participate in this emerging field at an earlier stage than would typically be possible for them. By making investments in companies that control intellectual property relevant to tiny technology, we are building a portfolio that we believe will be difficult to replicate, as we believe it will likely become increasingly difficult to create new foundational intellectual property in nanotechnology.

**TABLE OF FEES AND EXPENSES**

The following tables are intended to assist you in understanding the various costs and expenses directly or indirectly associated with investing in our Common Stock. Amounts are for the current fiscal year after giving effect to anticipated net proceeds for the 1,300,000 shares of Common Stock shares pursuant to this Prospectus Supplement and the accompanying Prospectus, assuming that we incur the estimated offering expenses. The price per share used in this calculation was the offering price of \$10.79.

## Shareholder Transaction Expenses

Sales Load <sup>(1)</sup> (as a percentage of offering price)	6.00%
Offering Expenses (as a percentage of offering price)	0.89%
Annual Expenses (as a percentage of net assets attributable to Common Stock)	
Management Fees <sup>(2)</sup>	N/A
Other Expenses <sup>(3)</sup>	
Salaries and Benefits <sup>(4)</sup>	6.92%
Administration and Operations <sup>(5)</sup>	1.76%
Professional Fees	0.56%
Total Annual Expenses <sup>(6)</sup>	9.24%

**Example**

The following examples illustrate the dollar amount of cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in our Common Stock. These amounts are based upon payment by us of expenses at levels set forth in the above table, including the non-cash, stock-based compensation expenses.

On the basis of the foregoing, including the non-cash, stock-based compensation expense, you would pay the following expenses on a \$10,000 investment, assuming a five percent annual return:\*

<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
\$1,532	\$3,112	\$4,560	\$7,676

\*This example includes non-cash, stock-based compensation. Excluding the non-cash, stock-based compensation, you would pay expenses of \$1,166 in one year, \$2,118 in three years, \$3,068 in five years and \$5,431 in 10 years, on a \$10,000 investment, assuming a five percent return.

The foregoing table is to assist you in understanding the various costs and expenses that an investor in our Common Stock will bear directly or indirectly. The assumed five percent annual return is not a prediction of, and does not represent, the projected or actual performance of our Common Stock. **The above example should not be considered a representation of future expenses, and actual expenses and annual rates of return may be more or less than those assumed for purposes of the example.**

- (1) This represents the placement fee of six percent (6%) of the of the gross proceeds of this offering.
- (2) The Company has no external management fees, as it is internally managed.
- (3) "Other Expenses" are based on estimated amounts for the current fiscal year.
- (4)

"Salaries and Benefits" includes non-cash stock-based compensation expense of \$5,228,419. The Company accounts for stock-based compensation expense pursuant to SFAS No. 123(R) "Share-Based Payment," which requires that we determine 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. There is no effect on net asset value from stock-based compensation expense at the time of grant. If options are exercised, net asset value per share will be decreased if the net asset value per share at the time of exercise is higher than the exercise price and net asset value per share will be increased if the net asset value per share at the time of exercise is lower than the exercise price. Excluding the non-cash, stock-based compensation expense, "Salaries and benefits" total \$3,592,630 or 2.80 percent of net assets attributable to Common Stock.

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(5) "Administration and Operations" includes expenses incurred for administration, operations, rent, directors' fees and expenses, depreciation and custodian fees.

(6) "Total Annual Expenses" includes non-cash compensation expense of \$5,228,419. See Footnote (4) above. Cash-based total annual expenses as a percentage of net assets attributable to Common Stock are 5.13 percent.

### **RISK FACTOR**

On June 14, 2007, our net asset value per share was \$5.28. Given that we are selling up to 1,300,000 shares of Common Stock, the net asset value per share after giving effect to the offering will be approximately \$5.59, less than the price you paid in the offering. For additional risk factors, please see "Risk Factors" on page 11 in the accompanying prospectus.

### **FORWARD-LOOKING INFORMATION**

This Prospectus Supplement 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 Prospectus Supplement. The forward-looking statements made in this Prospectus Supplement 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.

You should understand that under Sections 27A(b)(2)(B) and (D) of the Securities Act of 1933 and Sections 21E(b)(2)(B) and (D) of the Securities Exchange Act of 1934, the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 may not as a technical matter apply to statements made in connection with this offering.

### **USE OF PROCEEDS**

We estimate the total net proceeds of the offering to be approximately \$13,060,880.

We expect to invest or reserve for potential follow-on investment the net proceeds of any offering within two years from the completion of such offering. The net proceeds of this offering invested after two years will only be used for follow-on investments. Reserves for follow-on investments in any particular initial investment may be no more than the greater of twice the investment to-date or five times the initial investment in the case of seed-stage investments, though we may invest more than the amount reserved for this purpose in any particular portfolio holding. Although we intend to make our initial investments exclusively in companies that we believe are involved significantly in tiny technology, we may also make follow-on investments in existing portfolio companies involved in other technologies. Pending investment in portfolio companies, we intend to invest the net proceeds of any offering of our Common Stock in time deposits and/or income-producing securities that are issued or guaranteed by the federal government or an agency of the federal government or a government-owned corporation, which may well yield less than our operating expense ratio. We may also use the proceeds of this offering for operating expenses, including due diligence expenses on potential investments. Our portfolio companies rarely pay us dividends or interest, and we do not generate enough income from fixed income investments to meet all of our operating expenses. If we pay operating expenses from the proceeds, it will reduce the net proceeds of the offering that we will have available for investment.



**CAPITALIZATION**

We are authorized to issue 45,000,000 shares of Common Stock, par value \$0.01 per share, and 2,000,000 shares of preferred stock, par value \$0.10 per share. Each share within a particular class or series thereof has equal voting, dividend, distribution and liquidation rights. When issued, in accordance with the terms thereof, shares of Common Stock will be fully paid and non-assessable. Shares of Common Stock are not redeemable and have no preemptive, conversion, or cumulative voting rights.

The following table shows the number of shares of (i) capital stock authorized, (ii) the amount held by us or for our own account, and (iii) capital stock outstanding for each class of our authorized securities as of June 13, 2007.

<b>Title of Class</b>	<b>Amount Authorized</b>	<b>Amount Held by Company or for its Own Account</b>	<b>Amount Outstanding</b>
Common Stock	45,000,000	1,828,740	21,806,896 <sup>(1)</sup>
Preferred Stock	2,000,000	0	0

<sup>(1)</sup> The number of shares of our Common Stock to be outstanding excludes:

- options to purchase approximately 2,907,732 shares of Common Stock at an exercise price of \$10.11 outstanding as of June 15, 2007; and
- approximately 192,986 additional shares of Common Stock reserved for issuance under our equity incentive plans as of June 15, 2007.

**PRICE RANGE OF COMMON STOCK**

**Our Common Stock is traded on the Nasdaq Global Market under the symbol "TINY."**

The following table sets forth for the quarters indicated, the high and low sale prices on the Nasdaq Global Market per share of our Common Stock and the net asset value and the premium or discount from net asset value per share at which the shares of Common Stock were trading, expressed as a percentage of net asset value, at each of the high and low sale prices provided.

<b>Quarter Ended</b>	<b>Market Price</b>		<b>Net Asset Value ("NAV") Per Share at End of Period</b>	<b>Premium or Discount as a % of NAV</b>	
	<b>High</b>	<b>Low</b>		<b>High</b>	<b>Low</b>
March 31, 2005	16.80	11.30	4.20	300.0%	169.0%
June 30, 2005	13.38	10.01	4.61	190.2	117.1
September 30, 2005	13.85	10.70	5.94	133.2	80.1
December 31, 2005	14.95	10.15	5.68	163.2	78.7
March 31, 2006	16.10	12.75	5.60	187.5	127.7
June 30, 2006	14.26	9.57	5.54	157.4	72.7
September 30, 2006	12.99	9.38	5.54	134.5	69.3
December 31, 2006	15.16	11.80	5.42	179.7	117.7

March 31, 2007	13.58	11.00	5.27	157.7	108.7
Second Quarter through June 15, 2007	14.32	11.01	5.28	171.2	108.5

Historically, the shares of our Common Stock have traded at times at a discount and at other times at a premium to net asset value. Since 2003, our shares of Common Stock have traded at a premium to net asset value. The last reported price for our Common Stock on June 15, 2007 was \$11.95 per share. As of June 14, 2007, we had approximately 136 shareholders of record.

As of June 14, 2007, our net asset value per share was \$5.28.

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## RECENT DEVELOPMENTS

On April 23, 2007, Michael A. Janse, age 38, joined us as a Managing Director and Executive Vice President. He will be based in our Palo Alto, California, office. From March 2001 to December 2006, Mr. Janse was an Associate and since January 2007, had been a Principal with Arch Venture Partners, a Chicago based venture capital firm. He was graduated from the University of Chicago Graduate School of Business (M.B.A., Finance and Accounting), and Brigham Young University (B.S., Chemical Engineering).

On May 8, Daniel V. Leff, Managing Director and Executive Vice President, informed Harris & Harris Group, Inc., of his intention to resign from us in order to pursue other opportunities in venture capital. Mr. Leff will remain employed by us and keep his office in Los Angeles, California, through September 30, 2007, to ensure an orderly transition of his current roles and responsibilities

On May 11, 2007, we made two follow-on investments totaling \$507,042 in two privately held tiny technology portfolio companies.

In May 2007, we issued 442,415 shares of our Common Stock upon the exercise of employee stock options. We received proceeds of \$4,472,816.

In June 2007, we issued 23,452 shares of our Common Stock upon the exercise of employee stock options. We received proceeds of \$237,100.

On June 6, 2007, we made a \$2,000,000 initial investment in a privately held tiny technology company.

## SELECTED CONDENSED CONSOLIDATED FINANCIAL DATA

Quarterly financial information is derived from unaudited financial data, but in the opinion of management, reflects all adjustments (consisting of normal recurring adjustments) that are necessary to present fairly the results of such interim periods. Interim results as of and for the three months ended March 31, 2007, are not necessarily indicative of the results that may be expected for the year ended March 31, 2007. The information below should be read in conjunction with the Consolidated Financial Statements and Supplementary Data and the notes thereto. Financial information as of and for the years ended December 31, 2006, 2005, 2004, 2003 and 2002, has been derived from our financial statements that were audited by PricewaterhouseCoopers LLP. These historical results are not necessarily indicative of the results to be expected in the future.

### SELECTED QUARTERLY DATA (UNAUDITED)

2007

#### 1<sup>st</sup> Quarter

Total investment income	\$	652,498
Net operating loss	\$	(2,677,118)
Net increase (decrease) in net assets resulting from operations	\$	(6,390,160)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$	(0.30)

2006

	<b>1<sup>st</sup> Quarter</b>	<b>2<sup>nd</sup> Quarter</b>	<b>3<sup>rd</sup> Quarter</b>	<b>4<sup>th</sup> Quarter</b>
Total investment income	\$ 804,862	\$ 785,265	\$ 719,619	\$ 719,015
Net operating loss	\$ (767,743)	\$ (693,887)	\$ (2,988,790)	\$ (3,162,515)
Net increase (decrease) in net assets resulting from operations	\$ (1,653,990)	\$ (1,282,997)	\$ (2,588,092)	\$ (6,248,033)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.08)	\$ (0.06)	\$ (0.12)	\$ (0.31)

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**SELECTED QUARTERLY DATA (UNAUDITED)**

(continued)

	<b>2005</b>			
	<b>1<sup>st</sup> Quarter</b>	<b>2<sup>nd</sup> Quarter</b>	<b>3<sup>rd</sup> Quarter</b>	<b>4<sup>th</sup> Quarter</b>
Total investment income	\$ 260,108	\$ 158,717	\$ 315,374	\$ 801,662
Net operating loss	\$ (745,590)	\$ (3,302,094)	\$ (3,273,797)	\$ 1,851,274
Net increase (decrease) in net assets resulting from operations	\$ (2,233,447)	\$ 7,001,847	\$ 7,336,923	\$ (5,388,947)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.13)	\$ 0.41	\$ 0.40	\$ (0.26)

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS**

The information contained in this section should be read in conjunction with the Company's unaudited March 31, 2007 Consolidated Financial Statements and the Company's audited 2006 Consolidated Financial Statements and notes thereto.

In 1994, we made our first tiny technology investment. From August 2001 through March 31, 2007, all 32 of our initial investments have been in tiny technology. From August 2001 through March 31, 2007, we have invested a total (before any subsequent write-ups, write-downs or dispositions) of \$70,897,446 in tiny technology.

The following is a summary of our initial and follow-on investments in tiny technology from 2001 to the present. We consider a "round led" to be a round where we were the new investor or the leader of a set of new investors in an investee company. Typically, but not always, the lead investor negotiates the price and terms of a deal with the investee company.

	2001	2002	2003	2004	2005	2006	2007
Total Incremental Investments	\$ 489,999	\$ 6,240,118	\$ 3,812,600	\$ 14,837,846	\$ 16,251,339	\$ 24,408,187	\$ 4,857,357
No. of New Investments	1	7	5	8	4	6	1
No. of Follow-On Investment Rounds	0	1	5	21	13	14	6
No. of Rounds Led	0	1	0	2	0	7	1
Average Dollar Amount - Initial	\$ 489,999	\$ 784,303	\$ 437,156	\$ 911,625	\$ 1,575,000	\$ 2,383,424	\$ 1,147,826
Average Dollar Amount - Follow-On	N/A	\$ 750,000	\$ 325,364	\$ 359,278	\$ 765,488	\$ 721,974	\$ 618,255

We currently have 28 tiny technology companies in our portfolio. At March 31, 2007, from first dollar in, the average and median holding periods for these 28 venture capital investments were 2.92 years and 2.37 years, respectively.

We value our private venture capital investments each quarter as determined in good faith by our Valuation Committee, a committee of all of our 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.")

In the years 2001, 2002, 2003, 2004, 2005 and 2006, the Company recorded the following gross write-downs in privately held securities as a percentage of net assets at the beginning of the year:

	2001	2002	2003	2004	2005	2006	YTD 2007
Net Asset Value, Beginning of Year	\$ 31,833,475	\$ 24,334,770	\$ 27,256,046	\$ 40,682,738	\$ 74,744,799	\$ 117,987,742	\$ 113,930,303
Gross Write-Downs During Year	\$ (2,532,730)	\$ (5,400,005)	\$ (1,256,102)	\$ (5,711,229)	\$ (3,450,236)	\$ (4,211,323)	\$ (4,043,077)
Gross Write-Downs as a Percentage of Net Asset Value	-7.96%	-22.19%	-4.61%	-14.04%	-4.62%	-3.57%	-3.55%



The following is a history of the changes in our per share NAV, by quarter:

	<b>31-Dec-00</b>	<b>31-Mar-01</b>	<b>30-June-01</b>	<b>30-Sep-01</b>	<b>31-Dec-01</b>
NAV per Share	\$ 3.51	\$ 3.09	\$ 3.29	\$ 2.92	\$ 2.75
\$ Change		(0.42)	0.20	(0.37)	(0.17)
% Change		-11.97%	6.47%	-11.25%	-5.82%

	<b>31-Mar-02</b>	<b>30-June-02</b>	<b>30-Sep-02<sup>(1)</sup></b>	<b>31-Dec-02</b>
NAV per Share	\$ 2.63	\$ 2.68	\$ 2.61	\$ 2.37
\$ Change	(0.12)	0.05	(0.07)	(0.24)
% Change	-4.36%	1.90%	-2.61%	-9.20%

	<b>31-Mar-03</b>	<b>30-June-03</b>	<b>30-Sep-03</b>	<b>31-Dec-03<sup>(1)</sup></b>
NAV per Share	\$ 2.26	\$ 2.22	\$ 2.11	\$ 2.95
\$ Change	(0.11)	(0.04)	(0.11)	0.84
% Change	-4.64%	-1.77%	-4.95%	39.81%

	<b>31-Mar-04</b>	<b>30-June-04</b>	<b>30-Sep-04<sup>(1)</sup></b>	<b>31-Dec-04</b>
NAV per Share	\$ 3.01	\$ 2.85	\$ 4.44	\$ 4.33
\$ Change	0.06	(0.16)	1.59	(0.11)
% Change	2.03%	-5.32%	55.79%	-2.48%

	<b>31-Mar-05</b>	<b>30-June-05</b>	<b>30-Sep-05<sup>(1)</sup></b>	<b>31-Dec-05</b>
NAV per Share	\$ 4.20	\$ 4.61	\$ 5.94	\$ 5.68
\$ Change	(0.13)	0.41	1.33	(0.26)
% Change	-3.00%	9.76%	28.85%	-4.38%

	<b>31-Mar-06</b>	<b>30-June-06</b>	<b>30-Sep-06</b>	<b>31-Dec-06</b>
NAV per Share	\$ 5.60	\$ 5.54	\$ 5.54	\$ 5.42
\$ Change	(0.08)	(0.06)	0.00	(0.12)
% Change	-1.41%	-1.07%	0.00%	-2.17%

	<b>31-Mar-07</b>
NAV per Share	\$ 5.27
\$ Change	(0.15)
% Change	-2.77%

<sup>(1)</sup> The Company completed issuances for new shares of our common stock on September 14, 2005, July 7, 2004, December 24, 2003 and July 8, 2002.

We have discretion in the investment of our capital. However, we invest primarily in illiquid equity securities of private companies. Generally, these investments take the form of preferred stock, are subject to restrictions on resale and have no established trading market. Our principal objective is to achieve long-term capital appreciation. 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.



We present the financial results of our operations utilizing accounting principles generally accepted in the United States 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 Income / (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 and on sales of additional shares, 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.

## **Results of Operations**

### ***Three months ended March 31, 2007, as compared to the three months ended March 31, 2006***

In the three months ended March 31, 2007, and March 31, 2006, we had net decreases in net assets resulting from operations of \$6,390,160 and \$1,653,990, respectively.

#### Investment Income and Expenses:

We had net operating losses of \$2,667,118 and \$767,743 for the three months ended March 31, 2007, and March 31, 2006, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses. During the three months ended March 31, 2007, and 2006, total investment income was \$652,498 and \$804,862, respectively. During the three months ended March 31, 2007, and 2006, total operating expenses were \$3,319,616 and \$1,572,605, respectively.

During the three months ended March 31, 2007, as compared with the same period in 2006, investment income decreased owing to a decrease in our average holdings of U.S. government and agency securities. During the three months ended March 31, 2007, our average holdings of such securities were \$60,084,828, as compared with \$76,957,955 during the three months ended March 31, 2006.

The increase in operating expenses for the three months ended March 31, 2007, as compared to the three months ended March 31, 2006, was primarily owing to increases in salaries, benefits and stock-based compensation expense, and directors' fees and expenses, partially offset by a decrease in professional fees. Salaries, benefits and stock-based compensation expense increased by \$1,748,405, or 222.34 percent, through March 31, 2007, as compared to March 31, 2006, primarily as a result of non-cash expense of \$1,690,181 associated with the Stock Plan. While the non-cash stock-based compensation expense for the Stock Plan increased our operating expenses by \$1,690,181, 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. Directors' fees and expenses increased by \$55,294, or 64.4 percent, primarily as a

result of additional meetings held in the period ended March 31, 2007, as well as an increase in the monthly retainers paid to Committee Chairs and the Lead Independent Director, as compared with the period ended March 31, 2006. Professional fees decreased by \$107,692, or 37.15 percent, for the three months ended March 31, 2007, as compared with the same period in 2006, primarily as a result of a reduction of some legal and accounting fees.

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Realized Income and Losses from Investments:

During the three months ended March 31, 2007, we realized net losses on investments of \$674, as compared with realized net gains on investments of \$11,953 during the three months ended March 31, 2006.

During the three months ended March 31, 2007, we realized net losses of \$674, consisting primarily of income from our investment in AlphaSimplex Group, LLC, offset by losses in Exponential Business Development Company.

During the three months ended March 31, 2006, we realized net gains of \$11,953, consisting primarily of proceeds received from the liquidation of Optiva, Inc., offset by losses realized on our investment in AlphaSimplex Group, LLC.

Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the three months ended March 31, 2007, net unrealized depreciation on total investments increased by \$3,637,463, or 40.4 percent, from net unrealized depreciation of \$9,007,420 at December 31, 2006, to net unrealized depreciation of \$12,644,883 at March 31, 2007. Net unrealized depreciation on total investments increased by \$888,594, or 19.4 percent, during the three months ended March 31, 2006, from \$4,588,550 at December 31, 2005, to \$5,477,145 at March 31, 2006.

During the three months ended March 31, 2007, net unrealized depreciation on our venture capital investments increased by \$3,833,052, from \$8,450,969 to \$12,284,021, owing primarily to decreases in the valuations of our investments in Chlorogen, Inc., of \$1,370,699, Evolved Nanomaterial Sciences, Inc., of \$1,228,281, Nanomix, Inc., of \$459,772, NanoOpto Corporation of \$892,409 and Questech Corporation of \$91,916, and an increase in the valuation of our investment in Polatis, Inc., of \$190,680. We also had an increase owing to foreign currency translation of \$18,156 on our investment in D-Wave Systems, Inc. Unrealized depreciation on our U.S. government and agency securities portfolio decreased from \$556,451 at December 31, 2006, to \$360,862 at March 31, 2007.

During the three months ended March 31, 2006, net unrealized depreciation on our venture capital investments increased by \$191,545, from \$4,519,009 to \$4,710,554, owing primarily to a decrease in the valuation of our investment in Zia Laser, Inc. Unrealized depreciation on our U.S. government and agency securities portfolio increased from \$69,541 at December 31, 2005, to \$766,591 at March 31, 2006.

*Years Ended December 31, 2006, 2005, and 2004*

During the three years ended December 31, 2006, 2005, and 2004, we had net (decreases) increases in net assets resulting from operations of \$(11,773,112), \$6,716,376 and (\$2,066,114), respectively.

Investment Income and Expenses:

During the three years ended December 31, 2006, 2005, and 2004, we had net operating losses of \$7,612,935, \$5,465,761 and \$3,408,779, respectively. The variation in these results is primarily owing to increases in investment income offset by increases in operating expenses, including non-cash expense of \$5,038,956 in 2006 associated with the granting of stock options. During the three years ended December 31, 2006, 2005 and 2004, total investment income was \$3,028,761, \$1,540,862 and \$637,562, respectively. During the three years ended December 31, 2006, 2005 and 2004, total operating expenses were \$10,641,696, \$7,006,623 and \$4,046,341, respectively.

During 2006, investment income increased owing to an increase in our average holdings of U.S. government and agency securities, as our average holdings increased from \$51,120,727 at December 31, 2005, to \$67,277,409 at December 31, 2006, and as a result of an increase in interest rates during the year. During 2005, investment income

increased owing to an increase in our income on U.S. government and agency securities, as our holdings increased from \$44,622,722 at December 31, 2004, to \$96,250,864 at December 31, 2005, and as a result of an increase in interest rates during the year.

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The increase in operating expenses for the year ended December 31, 2006, was primarily owing to increases in salaries, benefits and stock-based compensation expense, and directors' fees and expenses, partially offset by decreases in administrative and operations expenses, profit-sharing expense and professional fees. Salaries, benefits and stock-based compensation expense increased by \$5,474,243, or 222.6 percent, for the year ended December 31, 2006, as compared with December 31, 2005, primarily as a result of non-cash expense of \$5,038,956 associated with the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan") adopted during the second quarter of 2006, and secondarily as a result of an increase in the number of full-time employees. The increase in salaries, benefits and stock-based compensation expense reflects expenses associated with ten full-time employees and one part-time employee during the year ended December 31, 2006, as compared with an average of nine full-time employees during the year ended December 31, 2005. Salaries, benefits and stock-based compensation include \$5,038,956 of non-cash expense associated with the Stock Plan, versus no such charge in 2005. Directors' fees and expenses increased by \$31,876, or 10.3 percent, as a result of additional meetings held in 2006 related to the adoption of the Stock Plan. Administrative and operations expense decreased by \$69,274, or 5.3 percent, primarily as a result of a decrease in our directors' and officers' liability insurance expense and decreases in the cost of proxy-related expenses. Profit-sharing expense for the year ended December 31, 2006, was \$50,875, as compared with \$1,796,264 for December 31, 2005, owing to the termination of the profit-sharing plan effective May 4, 2006. We recorded \$50,875 of profit-sharing expense toward the remainder of the 2005 profit-sharing payment in the year ended December 31, 2006, because of updated estimates of our ultimate tax liability for 2005. Professional fees decreased by \$92,234, or 11.1 percent, for the year ended December 31, 2006, as compared with December 31, 2005. Professional fees were lower for the year ended December 31, 2006, as compared with December 31, 2005, primarily as a result of the elimination of consulting costs incurred for a temporary Senior Controller in 2005 and the reduction of some of our Sarbanes-Oxley-related compliance costs incurred in 2005.

The increase in operating expenses during 2005 was primarily owing to increases in the profit-sharing provision, salaries and benefits, professional fees, administration and operations, rent expense and Directors' fees and expenses. Profit-sharing expense for 2005 was \$1,796,264, an increase of \$1,484,670 as compared with 2004. Profit-sharing expense increased primarily as a result of the gains realized on the sale of NeuroMetrix, Inc., offset by the taxes payable by the Company on the deemed dividend and taxes payable on Built-In Gains. The profit-sharing expense is also impacted by the Company's decision to retain its net realized long-term capital gains for reinvestment for growth, rather than distribute them as a cash dividend. When the Company chooses to retain its net realized long-term capital gains, it declares a deemed dividend and pays taxes on behalf of shareholders. Conversely, when the Company distributes its net realized long-term capital gains as a cash dividend, the shareholders pay all of the taxes. The taxes payable by the Company on behalf of shareholders reduce the amount of profit against which the profit-sharing payable to employees is calculated. Had the Company chosen to distribute its net realized long-term capital gains as a cash dividend, the provision for employee profit sharing would have been \$3,420,737 for 2005, rather than the actual provision for employee profit sharing of \$1,796,264 for 2005.

For the year ended December 31, 2005, as compared with 2004, salaries and benefits increased by \$530,945, or 27.5 percent, primarily as a result of the addition of three employees. Professional fees increased by \$162,751, or 24.4 percent, reflecting in part the expenses associated with ongoing compliance with the Sarbanes-Oxley Act of 2002. Administration and operations increased by \$600,824, or 83.6 percent, primarily as the result of increases in travel expenses associated with additional investments in portfolio companies, increases in expenses related to the preparation and distribution of the annual and quarterly reports and proxy statement owing to the increased number of shareholders, and an increase in the premium expense for director and officer liability insurance. The premium expense for directors and officers liability insurance increased by \$339,810 to \$512,038 in 2005, and the premium expense for 2006 is estimated to be \$514,650. Rent expense increased by \$60,148 or 39.7 percent, owing primarily to the leasing of additional office space in California and New York. Directors' fees and expenses in 2005 increased by \$99,664 or 47.6 percent as a result of an increase in the fees paid to the directors for monthly retainer and meeting attendance.

Realized Income and Losses from Investments:

During the years ended December 31, 2006, 2005 and 2004, we had net realized income from investments of \$258,693, \$14,208,789 and \$858,503, respectively. The variation in these results is primarily owing to variations in gross realized income from investments and income taxes in each of the three years. For the years ended December 31, 2006, 2005 and 2004, realized income from investments, before taxes, was \$31,338, \$23,862,037 and \$813,994, respectively. Income tax (benefit) expense for the years ended December 31, 2006, 2005 and 2004 was \$(227,355), \$9,653,248 and (\$44,509).

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During the year ended December 31, 2006, we realized net gains of \$31,338, consisting primarily of proceeds received from the liquidation of Optiva, Inc., proceeds received from Exponential Business Development, and net losses realized on our investment in AlphaSimplex Group, LLC. During 2005, we deemed the securities we held in Optiva, Inc., worthless and recorded the proceeds received and due to us on the liquidation of our bridge notes, realizing a loss of \$1,619,245. At December 31, 2005, we recorded a \$75,000 receivable for estimated proceeds from the final payment on the Optiva, Inc., bridge notes. During the first quarter of 2006, we received payment of \$95,688 from these bridge notes, resulting in the realized gain of \$20,688 on Optiva, Inc. During the year ended December 31, 2006, we realized tax benefits of \$227,355 for 2005 taxes that have been refunded.

During the year ended December 31, 2005, our realized income from investments before taxes of \$23,862,037 consisted primarily of a realized gain of \$30,179,762 from the sale of our investment in NeuroMetrix, Inc., offset by realized losses of \$1,358,286, \$2,093,968, \$1,091,209 and \$1,619,245, from the sale of our shares in Agile Materials & Technologies, Inc., Experion Systems, Inc., Nanotechnologies, Inc., and Optiva, Inc., respectively. Realized losses on U.S. government and agency securities totaled \$422,383 for 2005. For the year ended December 31, 2005, our income tax expense on realized gains was \$9,653,248, which includes \$8,122,367 of taxes payable by the Company on behalf of shareholders in connection with the deemed dividend and \$1,364,470 of taxes on Built-In Gains.

During the year ended December 31, 2004, our realized income from investments before taxes of \$813,994 consisted primarily of a realized gain of \$1,681,259 from the sale of our investment in NanoGram Devices Corporation, offset by a realized loss of \$915,108 from the sale of our shares of Series D Convertible Preferred Stock in NeoPhotonics Corporation. For the year ended December 31, 2004, our income tax benefit on realized gains and losses was \$44,509, which related primarily to taxes owed to Harris & Harris Enterprises.

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

During the year ended December 31, 2006, net unrealized depreciation on total investments increased by \$4,418,870. During the year ended December 31, 2005, net unrealized depreciation on total investments increased by \$2,026,652. During the year ended December 31, 2004, net unrealized depreciation on total investments decreased by \$484,162.

The net increase in unrealized depreciation on our venture capital investments in 2006 was owing primarily to decreases in the valuation of our investments in Nanomix, Inc., of \$1,710,000, NanoOpto Corporation of \$1,211,259, NeoPhotonics Corporation of \$254,238, Polatis, Inc., of \$145,228, SiOnyx, Inc., of \$679,950 and Zia Laser, Inc., of \$172,500, and an increase in the valuations of our investments in Crystal IS of \$19,735 and Questech Corporation of \$259,628. We also had a decrease, owing to foreign currency translation, of \$34,103 on our investment in D-Wave Systems, Inc. Unrealized depreciation on our U.S. government and agency securities portfolio increased from \$69,541 at December 31, 2005, to \$556,451 at December 31, 2006.

The net increase in unrealized depreciation on our venture capital investments in 2005 was the result of the appreciation in value of \$19,790,298 on investments held, offset by depreciation of \$23,181,420 related to investments sold. The change in unrealized depreciation on investments held is owing to appreciation in our investment in NeuroMetrix, Inc., prior to the sale of our interest in it as well as increases in the valuations of NanoGram Corporation, Nanosys, Inc., and Nantero, Inc., of \$313,534, \$870,113 and \$813,771, respectively. These increases were offset by decreases in the valuations of AlphaSimplex Group LLC, CSwitch, Inc., Mersana Therapeutics, Inc., NanoOpto, Inc., Polatis, Inc., and Zia Laser, Inc., of \$109,464, \$500,000, \$563,097, \$529,997, \$169,827 and \$1,312,500, respectively. The change in unrealized depreciation on investments sold is owing to the realization of the gain on our investment in NeuroMetrix, Inc., offset by the realization of losses on our investments in Agile Materials and Technologies, Inc., Experion Systems, Inc., Nanotechnologies, Inc., and Optiva, Inc.



The net decrease in unrealized depreciation on our venture capital investments in 2004 was the result of the appreciation in value of \$264,170 on investments held and appreciation of \$915,118 related to investments sold. The change in unrealized depreciation on investments held is primarily owing to an increase in the valuation of our investment in NeuroMetrix, Inc., of \$6,288,405, offset by decreases in the valuations of our investments in Agile Materials and Technologies, Inc., of \$614,081, Experion Systems, Inc., of \$630,497, Nanotechnologies, Inc., of \$1,275,373, Optiva, Inc., of \$2,000,000, and Polatis, Inc., of \$1,162,208. The decrease in unrealized depreciation on investments sold was owing to the realization of the loss of \$915,108 on the sale of our shares of Series D Convertible Preferred Stock in NeoPhotonics Corporation. During 2004, unrealized depreciation on U.S. government and agency securities increased by \$321,370. In 2004, we incurred \$695,126 of income tax expense on Built-In Gains on NeuroMetrix, Inc.

## Financial Condition

### March 31, 2007

At March 31, 2007, our total assets and net assets were \$116,508,703 and \$112,526,302, respectively. At December 31, 2006, they were \$118,328,590 and \$113,930,303, respectively.

At March 31, 2007, net asset value per share ("NAV") was \$5.27, as compared with \$5.42 at December 31, 2006. At March 31, 2007, our shares outstanding increased to 21,341,029, as compared with 21,015,017 at December 31, 2006.

Significant developments in the three months ended March 31, 2007, included an increase in the value of our venture capital investments of \$1,027,132 and a decrease in the value of our investment in U.S. government and agency obligations of \$940,233. The increase in the value of our venture capital investments, from \$53,667,831 at December 31, 2006, to \$54,694,963 at March 31, 2007, resulted primarily from one new and six follow-on investments, partially offset by a net decrease of \$3,834,241 in the net value of our previous venture capital investments. The decrease in the value of our U.S. government and agency obligations, from \$58,656,147 at December 31, 2006, to \$57,715,914 at March 31, 2007, is primarily owing to the use of funds for investments totaling \$4,857,357, profit sharing payments of \$261,661 and net operating expenses offset by proceeds received from stock option exercises. During the three months ended March 31, 2007, the Company issued 326,012 shares of stock and received proceeds of \$3,295,978 as a result of option exercises.

The following table is a summary of additions to our portfolio of venture capital investments during the three months ended March 31, 2007:

New Investment	Amount
Adesto Technologies Corporation	\$ 1,147,826
Follow-on Investment	
BridgeLux, Inc.	\$ 350,877
Cambrios Technologies Corporation	\$ 1,300,000
Kereos, Inc.	\$ 540,000
NanoOpto Corporation	\$ 268,654
Nextreme Thermal Solutions, Inc.	\$ 750,000
Solazyme, Inc.	\$ 500,000
Total	\$ 4,857,357

The following tables summarize the fair values of our portfolios of venture capital investments and U.S. government and agency obligations, as compared with their cost, at March 31, 2007, and December 31, 2006:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Venture capital investments, at cost	\$ 66,978,984	\$ 62,118,800
Net unrealized depreciation <sup>(1)</sup>	12,284,021	8,450,969
<b>Venture capital investments, at fair value</b>	<b>\$ 54,694,963</b>	<b>\$ 53,667,831</b>

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
U.S. government and agency obligations, at cost	\$ 58,076,776	\$ 59,212,598
Net unrealized depreciation <sup>(1)</sup>	360,862	556,451
<b>U.S. government and agency obligations, at fair value</b>	<b>\$ 57,715,914</b>	<b>\$ 58,656,147</b>

<sup>(1)</sup>At March 31, 2007, and December 31, 2006, the net accumulated unrealized depreciation on investments was \$12,644,883 and \$9,007,420, respectively.

The following table summarizes the fair value composition of our venture capital investment portfolio at March 31, 2007, and December 31, 2006.

<b>Category</b>	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Tiny Technology	99.9%	99.9%
Other Venture Capital Investments	0.1%	0.1%
<b>Total Venture Capital Investments</b>	<b>100.0%</b>	<b>100.0%</b>

#### *December 31, 2006*

At December 31, 2006, our total assets and net assets were \$118,328,590 and \$113,930,303, respectively. Our net asset value ("NAV") per share at that date was \$5.42, and our shares outstanding increased to 21,015,017 at December 31, 2006.

During the twelve months ended December 31, 2006, significant developments included an increase in the value of our venture capital investments of \$20,480,498 and a decrease in the value of our investment in U.S. government and agency securities of \$37,594,717. The increase in the value of our venture capital investments, from \$33,187,333 at December 31, 2005, to \$53,667,831 at December 31, 2006, resulted primarily from six new and 10 follow-on investments, partially offset by a net decrease of \$3,927,689 in the net value of our previous venture capital investments. The decrease in the value of our U.S. government and agency securities, from \$96,250,864 at December 31, 2005, to \$58,656,147 at December 31, 2006, was primarily owing to the use of funds for investments totaling \$24,408,187, tax payments of \$9,425,922, profit-sharing payments of \$1,897,072, an increase in unrealized losses of \$486,910 and payment of net operating expenses.

During December 2006, the Company also issued stock and received proceeds upon the exercise of employee stock options. Through December 31, 2006, the Company issued 258,672 shares and received proceeds of \$2,615,190 as a result of option exercises.

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The Company's liabilities decreased from \$14,950,378 at December 31, 2005, to \$4,398,287 at December 31, 2006, primarily owing to the payment of the tax payable on behalf of shareholders of \$8,122,367 in January 2006, the payment of \$1,897,072 in profit sharing in March 2006 and the reversal of the accrual for federal and state taxes payable of \$1,514,967 recorded at December 31, 2005.

The following table is a summary of additions to our portfolio of venture capital investments made during the twelve months ended December 31, 2006, by portfolio company:

<b>New Investments</b>		<b>Amount</b>
D-Wave Systems, Inc.	\$	1,750,547
Evolved Nanomaterial Sciences, Inc.		2,800,000
Innovalight, Inc.		2,500,000
Metabolon, Inc.		2,500,000
SiOnyx, Inc.		750,000
Xradia, Inc.		4,000,000
<b>Follow-on Investments</b>		
Chlorogen, Inc.	\$	221,438
Crystal IS, Inc.		1,098,240
CSwitch Corporation		2,850,000
NanoGram Corporation		1,262,764
NanoOpto Corporation		433,138
NeoPhotonics Corporation		2,750,000
Nextreme		500,000
Polatis, Inc.		89,310
Questech Corporation		12,750
SiOnyx, Inc.		890,000
Total	\$	24,408,187

The following tables summarize the fair values of our portfolios of venture capital investments and U.S. government and agency securities, as compared with their cost, at December 31, 2006, and December 31, 2005:

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
Venture capital investments, at cost	\$ 62,118,800	\$ 37,706,342
Net unrealized depreciation	8,450,969	4,519,009
<b>Venture capital investments, at fair value</b>	<b>\$ 53,667,831</b>	<b>\$ 33,187,333</b>

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
U.S. government and agency securities, at cost	\$ 59,212,598	\$ 96,320,405
Net unrealized depreciation	556,451	69,541
<b>U.S. government and agency securities, at fair value</b>	<b>\$ 58,656,147</b>	<b>\$ 96,250,864</b>

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The following table summarizes the fair value composition of our venture capital investment portfolio at December 31, 2006, and December 31, 2005.

Category	December 31,	
	2006	2005
Tiny Technology	99.9%	99.9%
Other Venture Capital Investments	0.1%	0.1%
<b>Total Venture Capital Investments</b>	<b>100.0%</b>	<b>100.0%</b>

#### *December 31, 2005*

At December 31, 2005, our total assets and net assets were \$132,938,120 and \$117,987,742, respectively. Our net asset value ("NAV") per share at that date was \$5.68, and our shares outstanding increased to 20,756,345 versus 17,248,845 at December 31, 2004.

During the 12 months ended December 31, 2005, significant financial developments included the receipt of proceeds from our public offering of common stock and the sale of our investment in NeuroMetrix, Inc. Gross proceeds from the issuance of 3,507,500 new shares of our common stock totaled \$37,091,813, less costs of \$565,246, for net proceeds of \$36,526,567. The Company received proceeds of \$34,591,136 from the sale of its 1,137,570 shares of NeuroMetrix. In addition, the value of our venture capital investments increased by \$1,565,373, to \$33,187,333.

During the 12 months ended December 31, 2005, the value of our venture capital investments increased from \$31,621,960 at December 31, 2004 to \$33,187,333 at December 31, 2005. This increase included \$16,251,339 from four new and 11 follow-on venture capital investments and increases in the valuations of NanoGram Corporation, Nanosys, Inc. and Nantero, Inc. of \$313,534, \$870,113 and \$813,771, respectively, offset by the sale of our interests in Agile Materials & Technologies, Inc., Experion Systems, Inc., Nanotechnologies, Inc., NeuroMetrix, Inc., and Optiva, Inc., and by decreases in the valuation of our investments in AlphaSimplex Group LLC, CSwitch Corporation, Mersana Therapeutics, Inc., NanoOpto Corporation, Polatis, Inc., and Zia Laser, Inc., of \$109,464, \$500,000, \$563,097, \$529,997, \$169,827 and \$1,312,500, respectively.

The increase in the value of our investment in U.S. government and agency securities, from \$44,622,722 at December 31, 2004, to \$96,250,864 at December 31, 2005, resulted primarily from the receipt of net proceeds of \$36,526,567 pursuant to the issuance of 3,507,500 new shares of our common stock and proceeds from the sale of NeuroMetrix of \$34,591,136. These increases were partially offset by four new venture capital investments and eleven follow-on investments totaling \$16,251,339, as well as by operating expenses.

The Company's liabilities increased from \$4,616,652 at December 31, 2004, to \$14,959,881 at December 31, 2005. The increases were attributable to an increase of \$1,796,264 in the profit-sharing accrual, the provision of \$8,122,367 for taxes payable by the Company on behalf of shareholders on the deemed dividend and provision for current taxes payable of \$1,524,470.



The following table is a summary of additions to our portfolio of venture capital investments during the 12 months ended December 31, 2005:

<u>New Investment</u>	Amount
eLite Optoelectronics, Inc.	\$ 1,000,000
Kereos, Inc.	800,000
Kovio, Inc.	3,000,000
Zia Laser, Inc.	1,500,000
<u>Follow-on Investments</u>	
Cambrios Technologies Corporation	\$ 511,006
Chlorogen, Inc.	364,261
Kereos, Inc.	160,000
Molecular Imprints, Inc.	2,500,000
Nanomix, Inc.	250,000
NanoOpto Corporation	411,741
Mersana Therapeutics, Inc.	683,000
Nanosys, Inc.	3,000,003
Nantero, Inc.	571,329
NeoPhotonics Corporation	999,999
Starfire Systems, Inc.	500,000
<b>Total</b>	<b>\$ 16,251,339</b>

## **Cash Flow**

### ***Year Ended December 31, 2006***

Net cash used in operating activities for the year ended December 31, 2006, was \$14,955,302, primarily owing to the payment of various federal, state and local taxes, including the tax paid on behalf of shareholders for the deemed dividend, and to the payment of operating expenses.

Cash provided by investing activities for the year ended December 31, 2006, was \$13,198,611, primarily reflecting net proceeds from the sale of U.S. government and agency securities of \$37,593,589, less investments in private placements of \$24,408,187.

Cash provided by financing activities for the year ended December 31, 2006, was \$2,615,190, reflecting the issuance of shares in connection with the Stock Plan.

### ***Year Ended December 31, 2005***

Net cash used in operating activities for the year ended December 31, 2005, was \$2,914,285, primarily owing to an increase in our operating expenses.

Cash used in investing activities for the year ended December 31, 2005, was \$33,049,325, primarily reflecting a net increase in our investment in U.S. government and agency securities of \$52,144,482 and investments in private placements of \$16,251,339, less proceeds from the sale of venture capital investments of \$35,392,200.

Cash provided by financing activities for the year ended December 31, 2005, was \$36,526,567, reflecting net proceeds from the issuance of 3,507,500 new shares of our common stock on September 14, 2005, in an underwritten follow-on

offering.

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***Year Ended December 31, 2004***

Net cash used in operating activities for the year ended December 31, 2004, was \$3,809,805, primarily owing to an increase in our operating expenses.

Cash used in investing activities for the year ended December 31, 2004, was \$32,093,612, primarily reflecting an increase in our investment in U.S. government and agency securities of \$17,823,606 and investments in private placements of \$16,731,216.

Cash provided by financing activities for the year ended December 31, 2004, was \$36,128,175, reflecting net proceeds from the issuance of 3,450,000 new shares of our common stock on July 7, 2004, in an underwritten follow-on offering.

**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 and invested \$406,936 in Otisville BioTech, Inc., which also completed an initial public offering later that year. In 1984, Charles E. Harris purchased a controlling interest in us which also made him the control person of Otisville. We then divested our other assets 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.

Throughout our corporate history, we have made early stage venture capital investments in a variety of industries. We define venture capital investments as investments in start-up firms and small businesses with exceptional growth potential. We have invested a substantial portion of our assets in venture capital investments of private, development stage or start-up companies. These private businesses tend to be thinly capitalized, unproven, small companies that lack management depth, have little or no history of operations and are developing unproven technologies. At December 31, 2006, \$53,667,831, or 47.1 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of \$8,450,969. At December 31, 2005, \$33,187,333, or 28.1 percent, of our net assets at fair value consisted of private venture capital investments, net of unrealized depreciation of \$4,519,009.

Since our investment in Otisville in 1983 through December 31, 2006, we have made a total of 73 venture capital investments, including four private placement investments in securities of publicly traded companies. We have sold 44 of these 73 investments, realizing total proceeds of \$143,614,382 on our invested capital of \$51,229,202. As measured from first dollar in to last dollar out, the average and median holding periods for these 44 investments were 3.63 years and 3.19 years, respectively. As measured by the 149 separate rounds of investment within these 44 investments, the average and median holding periods for the 149 separate rounds of investment were 2.84 years and 2.44 years, respectively.

**Liquidity and Capital Resources**

Our primary sources of liquidity are cash, receivables and freely marketable securities, net of short-term indebtedness. Our secondary sources of liquidity are restricted securities of companies that are publicly traded.

Our primary sources of liquidity are cash, receivables and freely marketable securities, net of short-term indebtedness. Our secondary sources of liquidity are restricted securities of companies that are publicly traded.

At March 31, 2007, and December 31, 2006, our total net primary liquidity was \$58,829,464 and \$61,323,306, respectively, and our secondary liquidity was \$0 and \$0, respectively.

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The decrease in our primary liquidity from December 31, 2006, to March 31, 2007, is primarily owing to the use of funds for investments and payment of net operating expenses.

In September 2005, we completed the sale of 3,507,500 common shares, for total gross proceeds of \$37,091,813; net proceeds, after offering costs of \$565,246, were \$36,526,567. We intend to use, and have been using, the net proceeds of this offering to make new investments in tiny technology, as well as for follow-on investments in our existing venture capital investments and for working capital. Through March 31, 2007, we have used \$25,048,657 of the net proceeds from this offering for these purposes.

#### ***December 31, 2006***

At December 31, 2006, and December 31, 2005, our total net primary liquidity was \$61,323,306 and \$97,797,219, respectively, and our secondary liquidity was \$0 and \$0, respectively.

Our net primary sources of liquidity are more than adequate to cover our gross cash operating expenses over the next 12 months. Our gross cash operating expenses for 2006 and 2005 totaled \$5,285,448 and \$5,021,066, respectively.

The decrease in our primary liquidity from December 31, 2005, to December 31, 2006, is primarily owing to the use of funds for investments, profit-sharing and tax payments, as well as for net operating expenses.

In 2004, we registered with the SEC for the sale of up to 7,000,000 shares of our common stock from time to time. In July 2004, we sold 3,450,000 common shares for gross proceeds of \$36,501,000; net proceeds, after offering costs of \$372,825, were \$36,128,175. In September 2005, we completed the sale of 3,507,500 common shares, for total gross proceeds of \$37,091,813; net proceeds, after offering costs of \$565,246, were \$36,526,567. We intend to use, and have been using, the net proceeds of the offerings to make new investments in tiny technology as well as follow-on investments in our existing venture capital investments, and for working capital. Through December 31, 2006, we used \$53,932,228 from these two offerings for these purposes.

#### ***December 31, 2005***

At December 31, 2005, and December 31, 2004, our total net primary liquidity was \$97,797,219 and \$45,353,691, respectively, and our secondary liquidity was \$0 and \$13,113,822, respectively.

Our net primary sources of liquidity were more than adequate to cover our gross cash operating expenses over the next 12 months. Our gross cash operating expenses for 2005 and 2004 totaled \$5,021,066 and \$3,878,610, respectively.

The increase in our primary source of liquidity from December 31, 2004, to December 31, 2005, was primarily owing to the receipt of the net proceeds from the issuance of 3,507,500 new shares of our common stock and the net proceeds from the sale of our investment in NeuroMetrix, Inc. These receipts were partially offset by our investments in Cambrios, Inc., Chlorogen, Inc., eLite Optoelectronics, Inc., Kereos, Inc., Kovio, Inc., Mersana Therapeutics, Inc., Molecular Imprints, Inc., Nanomix, Inc., NanoOpto Corporation, Nanosys, Inc., Nantero, Inc., NeoPhotonics Corporation, Starfire Systems, Inc., and Zia Laser, Inc., and the use of funds for net operating expenses.

On November 19, 2001, we established an asset account line of credit. The asset account line of credit was secured by U.S. government and agency securities. Under the asset account line of credit, we were able to borrow up to \$8,000,000. The asset account line of credit could be increased to up to 95 percent of the current value of the U.S. government and agency securities with which we secure the line. The asset account line of credit carried interest at a rate of the Broker Call Rate plus 50 basis points. Our outstanding balance under the asset account line of credit at December 31, 2004, was \$0. The Company terminated this line of credit on November 1, 2005.



## PLAN OF DISTRIBUTION

Global Crown Capital, LLC (the “placement agent”), located at 101 California Street, Suite 4550, San Francisco, CA 94111, has entered into a placement agency agreement with us in which they have agreed to act as placement agent in connection with this offering. Under the terms of the placement agency agreement, the placement agent has agreed to be our exclusive placement agent in connection with the issuance and sale by us of up to 1,300,000 shares of our Common Stock for \$10.79 in a proposed takedown from our registration statement. The offering price was determined by the 10-day volume-weighted average price (VWAP) minus five percent. The placement agent is not purchasing or selling any shares by this Prospectus Supplement or accompanying Prospectus, nor is it required to arrange for the purchase or sale of any specific number or dollar amount of shares, but has agreed to use best efforts to arrange for the sale of all 1,300,000 shares.

The terms of any such offering will be subject to market conditions and negotiations between us, the placement agent, and prospective purchasers. The shares will be offered to prospective purchasers for \$10.79 per share. The placement agency agreement provides that the obligations of the placement agent are subject to certain conditions precedent, including the absence of any material adverse change in our business and the receipt of certain certificates, opinions and letters from us and our counsel.

The placement agent proposes to arrange for the sale to one or more purchasers of the Common Stock offered pursuant to this Prospectus Supplement and the accompanying Prospectus through direct subscription agreements between the purchasers and us. Confirmations and definitive prospectuses will be distributed to all investors who agree to purchase the Common Stock, informing investors of the closing date as to such shares. We currently anticipate that closing of the sale of 1,300,000 shares of Common Stock will take place on or about June 20, 2007.

On the scheduled closing date, the following will occur:

- we will receive funds in the amount of the aggregate purchase price; and
- Global Crown Capital, LLC will receive the placement agent’s fee in accordance with the terms of the placement agent agreement.

We will deliver the Common Stock being issued to the purchasers electronically upon receipt of purchaser funds for the purchase of the shares of our Common Stock offered pursuant to this Prospectus Supplement. We will not issue certificated shares of Common Stock to purchasers in this offering.

The placement agent has informed us that it will not engage in over-allotment, stabilizing transactions or syndicate covering transactions in connection with this offering.

In order to facilitate the closing, certain purchaser funds will be deposited into a non-interest bearing escrow account and held by Citibank, N.A., as escrow agent, until jointly released by us and the placement agent in a written instruction to the escrow agent on the date the shares are delivered to the purchasers. The escrow agent will not accept any purchaser funds until the date of this Prospectus Supplement. The escrow agent or its affiliates may provide investment banking, additional commercial banking and/or other services to us from time to time, for which it may in the future receive customary fees and expenses.

We have agreed to indemnify the placement agent against certain liabilities, including liabilities under the 1933 Act, or to contribute to payments the placement agent may be required to make in respect of those liabilities; provided that such indemnification shall not extend to any liability or action resulting from the gross negligence or willful misconduct of the placement agent.

**Commissions and Discounts**

We have agreed to pay the placement agent a fee equal to 6.0 percent (6%) of the proceeds of this offering. Under no circumstances will the fee, commission or discount received by the placement agent or any other NASD member or independent broker-dealer exceed eight percent (8%) of the gross proceeds to us in this offering or any other offering in the United States pursuant to the Prospectus. The following table shows the per share and total fees we will pay to the placement agent in connection with the sale of the shares being offered pursuant to this Prospectus Supplement and the accompanying Prospectus, assuming the purchase of all the shares offered hereby.

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Per share placement agent's fee	\$0.65
Total placement agent's fee	\$841,620

We estimate that the total expenses of this offering that will be payable by us, excluding the placement agent's fee and the reimbursement of the placement agent for other reasonable expenses incurred in connection with this offering, will be approximately \$124,500. After deducting certain fees due to the placement agent and our estimated offering expenses, we expect the net proceeds from this offering to be up to approximately \$13,060,880.

### **LEGAL MATTERS**

Certain legal matters will be passed on by Skadden, Arps, Slate, Meagher & Flom LLP, New York, New York, our special counsel in connection with the offering of Common Stock.

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**CONSOLIDATED FINANCIAL STATEMENTS**HARRIS & HARRIS GROUP, INC.  
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### **Management's Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2006. In making its assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on the results of this assessment, management (including our Chief Executive Officer and Chief Financial Officer) has concluded that, as of December 31, 2006, the Company's internal control over financial reporting was effective.

Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm.

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## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of  
Harris & Harris Group, Inc.:

We have completed integrated audits of Harris & Harris Group, Inc.'s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

### Consolidated financial statements

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Harris & Harris Group, Inc. (the "Company") at December 31, 2006 and December 31, 2005, and the results of its operations, its cash flows, the changes in its net assets and the financial highlights for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at December 31, 2006 by correspondence with the custodian, provide a reasonable basis for our opinion.

As more fully disclosed in Note 2 of the Notes to Consolidated Financial Statements, the financial statements include investments valued at \$53,667,831 (47.1% of net assets) at December 31, 2006, the fair values of which have been estimated by the Board of Directors in the absence of readily ascertainable market values. Those estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material.

### Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP  
New York, New York  
March 15, 2007

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

December 31, 2006

December 31, 2005

ASSETS

Investments, at value (Cost: \$121,331,398 at 12/31/06, \$134,026,747 at 12/31/05)	\$	112,323,978	\$	129,438,197
Cash and cash equivalents		2,071,788		1,213,289
Restricted funds (Note 6)		2,149,785		1,730,434
Receivable from portfolio company		0		75,000
Receivable from broker (Note 3)		819,905		0
Interest receivable		625,372		248,563
Prepaid expenses		10,945		2,993
Other assets		326,817		229,644
<b>Total assets</b>	<b>\$</b>	<b>118,328,590</b>	<b>\$</b>	<b>132,938,120</b>

LIABILITIES & NET ASSETS

Accounts payable and accrued liabilities (Note 6)	\$	4,115,300	\$	3,174,183
Accrued profit sharing (Note 4)		261,661		2,107,858
Deferred rent		21,326		31,003
Current taxes payable		0		1,514,967
Taxes payable on behalf of shareholders (Note 7)		0		8,122,367
<b>Total liabilities</b>		<b>4,398,287</b>		<b>14,950,378</b>
<b>Net assets</b>	<b>\$</b>	<b>113,930,303</b>	<b>\$</b>	<b>117,987,742</b>

**Net assets are comprised of:**

Preferred stock, \$0.10 par value, 2,000,000 shares authorized; none issued	\$	0	\$	0
Common stock, \$0.01 par value, 45,000,000 shares authorized at 12/31/06 and 30,000,000 at 12/31/05; 22,843,757 issued at 12/31/06 and 22,585,085 issued at 12/31/05		228,438		225,851
Additional paid in capital (Note 9)		129,801,201		122,149,642
Accumulated net realized income (loss)		(3,747,912)		3,781,905
Accumulated unrealized depreciation of investments		(9,007,420)		(4,764,125)
Unrecognized net gain on retirement benefit plans (Note 6)		61,527		
Treasury stock, at cost (1,828,740 shares at 12/31/06 and 12/31/05)		(3,405,531)		(3,405,531)
<b>Net assets</b>	<b>\$</b>	<b>113,930,303</b>	<b>\$</b>	<b>117,987,742</b>
<b>Shares outstanding</b>		<b>21,015,017</b>		<b>20,756,345</b>



<b>Net asset value per outstanding share</b>	\$	5.42	\$	5.68
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**The accompanying notes are an integral part of these consolidated financial statements.**

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**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
<b>Investment income:</b>			
Interest from:			
Fixed-income securities	\$ 2,991,261	\$ 1,409,273	\$ 614,728
Portfolio companies	0	65,620	22,834
Miscellaneous income	37,500	65,969	0
<b>Total investment income</b>	<b>3,028,761</b>	<b>1,540,862</b>	<b>637,562</b>
<b>Expenses:</b>			
Salaries, benefits and stock-based compensation (Note 3)	7,933,276	2,459,033	1,928,088
Administration and operations	1,250,080	1,319,354	718,530
Profit-sharing provision (Note 4)	50,875	1,796,264	311,594
Professional fees	737,828	830,062	667,311
Rent	239,846	211,582	151,434
Directors' fees and expenses	340,750	308,874	209,210
Depreciation	64,916	64,713	43,151
Custodian fees	24,125	16,741	17,023
<b>Total expenses</b>	<b>10,641,696</b>	<b>7,006,623</b>	<b>4,046,341</b>
<b>Net operating loss</b>	<b>(7,612,935)</b>	<b>(5,465,761)</b>	<b>(3,408,779)</b>
<b>Net realized gain from investments:</b>			
Realized gain from investments	31,338	23,862,037	813,994
Income tax (benefit) expense (Note 7)	(227,355)	9,653,248	(44,509)
<b>Net realized gain from investments</b>	<b>258,693</b>	<b>14,208,789</b>	<b>858,503</b>
<b>Net (increase) decrease in unrealized depreciation on investments:</b>			
Change as a result of investment sales	0	(23,181,420)	915,118
Change on investments held	(4,418,870)	19,790,298	264,170
Change in unrealized depreciation on investments	(4,418,870)	(3,391,122)	1,179,288
Income tax (benefit) expense (Note 7)	0	(1,364,470)	695,126
<b>Net decrease (increase) in unrealized depreciation on investments</b>	<b>(4,418,870)</b>	<b>(2,026,652)</b>	<b>484,162</b>
<b>Net (decrease) increase in net assets resulting from operations:</b>			
<b>Total</b>	<b>\$ (11,773,112)</b>	<b>\$ 6,716,376</b>	<b>\$ (2,066,114)</b>
<b>Per average basic and diluted outstanding share</b>	<b>\$ (0.57)</b>	<b>\$ 0.36</b>	<b>\$ (0.13)</b>
<b>Average outstanding shares</b>	<b>20,759,547</b>	<b>18,471,770</b>	<b>15,476,714</b>

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



**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
<b>Cash flows used in operating activities:</b>			
Net (decrease) increase in net assets resulting from operations	\$ (11,773,112)	\$ 6,716,376	\$ (2,066,114)
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash used in operating activities:			
Net realized and unrealized loss (gain) on investments	4,420,619	(20,470,915)	(1,993,282)
Deferred income taxes	0	(1,364,470)	695,126
Depreciation and amortization	(426,168)	346,019	43,151
Taxes payable on behalf of shareholders on deemed dividend	0	8,122,367	0
Stock-based compensation expense	5,038,956	0	0
<b>Changes in assets and liabilities:</b>			
Restricted funds	(419,351)	(138,463)	(379,893)
Receivable from portfolio company	75,000	(65,000)	(10,000)
Interest receivable	(376,808)	(189,603)	(58,510)
Income tax receivable	0	(7,023)	14,895
Prepaid expenses	(7,951)	539,496	(535,648)
Other receivables	(819,905)	0	0
Other assets	(176,325)	11,599	(8,666)
Accounts payable and accrued liabilities	1,002,643	268,525	182,260
Accrued profit sharing	(1,846,197)	1,796,264	311,594
Deferred rent	(9,677)	(3,927)	(4,718)
Current income tax liability	(9,637,026)	1,524,470	0
<b>Net cash used in operating activities</b>	<b>(14,955,302)</b>	<b>(2,914,285)</b>	<b>(3,809,805)</b>
<b>Cash flows from investing activities:</b>			
Net (purchase) sale of short-term investments and marketable securities	37,593,589	(52,144,482)	(17,823,606)
Investment in private placements and loans	(24,408,187)	(16,251,339)	(16,731,216)
Proceeds from sale of investments	28,295	35,392,200	2,530,483
Purchase of fixed assets	(15,086)	(45,704)	(69,273)
<b>Net cash provided by (used in) investing activities</b>	<b>13,198,611</b>	<b>(33,049,325)</b>	<b>(32,093,612)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from public offering, net (Note 9)	0	36,526,567	36,128,175
Proceeds from stock option exercises (Note 3)	2,615,190	0	0
<b>Net cash provided by financing activities</b>	<b>2,615,190</b>	<b>36,526,567</b>	<b>36,128,175</b>

**Net increase in cash and cash equivalents:**

Cash and cash equivalents at beginning of the year	1,213,289	650,332	425,574
Cash and cash equivalents at end of the year	2,071,788	1,213,289	650,332

<b>Net increase in cash and cash equivalents</b>	<b>\$ 858,499</b>	<b>\$ 562,957</b>	<b>\$ 224,758</b>
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**Supplemental disclosures of cash flow information:**

Income taxes paid	\$ 9,425,922	\$ 0	\$ 0
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**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**

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
<b>Changes in net assets from operations:</b>			
Net operating loss	\$ (7,612,935)	\$ (5,465,761)	\$ (3,408,779)
Net realized income (loss) on investments	258,693	14,208,789	858,503
Net increase (decrease) in unrealized depreciation on investments as a result of sales	0	(23,181,420)	915,118
Net (increase) decrease in unrealized depreciation on investments held	(4,418,870)	19,790,298	264,170
Net change in deferred taxes	0	1,364,470	(695,126)
<b>Net increase (decrease) in net assets resulting from operations</b>	<b>(11,773,112)</b>	<b>6,716,376</b>	<b>(2,066,114)</b>
<b>Changes in net assets from capital stock transactions:</b>			
Issuance of common stock upon the exercise of stock options	2,587	0	0
Proceeds from sale of stock	0	35,075	34,500
Additional paid in capital on common stock issued	2,612,603	36,491,492	36,093,675
Stock based compensation expense	5,038,956	0	0
<b>Net increase in net assets resulting from capital stock transactions</b>	<b>7,654,146</b>	<b>36,526,567</b>	<b>36,128,175</b>
<b>Changes in net assets from adoption of SFAS No. 158</b>	<b>61,527</b>	<b>0</b>	<b>0</b>
<b>Net (decrease) increase in net assets</b>	<b>(4,057,439)</b>	<b>43,242,943</b>	<b>34,062,061</b>
<b>Net Assets:</b>			
Beginning of the year	117,987,742	74,744,799	40,682,738
End of the year	\$ 113,930,303	\$ 117,987,742	\$ 74,744,799

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (6)(7) - 15.61 % of net assets</b>			
<b>Private Placement Portfolio (Illiquid) - 15.61 % of net assets</b>			
AlphaSimplex Group, LLC (2) — Investment management company headed by Dr. Andrew W. Lo, holder of the Harris & Harris Group Chair at MIT Limited Liability Company Interest	(B)	—\$	10,521
Exponential Business Development Company (1)(2) — Venture capital partnership focused on early stage companies Limited Partnership Interest	(B)	—	0
Molecular Imprints, Inc. (1)(2) — Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(A)	1,333,333	2,000,000
Series C Convertible Preferred Stock	(A)	1,250,000	2,500,000
Warrants at \$2.00 expiring 12/31/11	(B)	125,000	0
			4,500,000
Nanosys, Inc. (1)(2)(5) — Developing zero and one-dimensional inorganic nanometer-scale materials for use in nanotechnology- enabled systems			
Series C Convertible Preferred Stock	(C)	803,428	2,370,113
Series D Convertible Preferred Stock	(C)	1,016,950	3,000,003
			5,370,116
Nantero, Inc. (1)(2)(5) — Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes			
Series A Convertible Preferred Stock	(C)	345,070	1,046,908
Series B Convertible Preferred Stock	(C)	207,051	628,172
Series C Convertible Preferred Stock	(C)	188,315	571,329
			2,246,409

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (6)(7) - 15.61 % of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 15.61 % of net assets (cont.)</b>			
NeoPhotonics Corporation (1)(2) — Developing and manufacturing planar optical devices and components			
Common Stock	(C)	716,195	\$ 133,141
Series 1 Convertible Preferred Stock	(C)	1,831,256	1,831,256
Series 2 Convertible Preferred Stock	(C)	741,898	741,898
Series 3 Convertible Preferred Stock	(C)	2,750,000	2,750,000
Warrants at \$0.15 expiring 01/26/10	(C)	16,364	164
Warrants at \$0.15 expiring 12/05/10	(C)	14,063	140
			5,456,599
Polatis, Inc. (1)(2)(5)(10) — Developing optical networking components by merging materials, MEMS and electronics technologies			
Series A-1 Convertible Preferred Stock	(B)	16,775	0
Series A-2 Convertible Preferred Stock	(B)	71,611	141,520
Series A-4 Convertible Preferred Stock	(B)	4,774	9,435
Series A-5 Convertible Preferred Stock	(B)	5,491	45,127
			196,082
<b>Total Unaffiliated Private Placement Portfolio (cost: \$18,107,124)</b>			<b>\$ 17,779,727</b>
<b>Total Investments in Unaffiliated Companies (cost: \$18,107,124)</b>			<b>\$ 17,779,727</b>

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



**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006**

	Method of Valuation (3)	Shares/Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(6)(8) -28.20% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) - 28.20% of net assets</b>			
BridgeLux, Inc. (1)(2)(11) — Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(A)	1,861,504	\$ 1,000,000
Cambrios Technologies Corporation (1)(2)(5) — Developing nanowire-enabled electronic materials for the display industry			
Series B Convertible Preferred Stock	(A)	1,294,025	1,294,025
Chlorogen, Inc. (1)(2)(5) — Developing patented chloroplast technology to produce plant-made proteins			
Series A Convertible Preferred Stock	(C)	4,478,038	785,000
Series B Convertible Preferred Stock	(C)	2,077,930	364,261
Secured Convertible Bridge Note (including interest)	(A)	\$ 221,438	225,697
			1,374,958
Crystal IS, Inc. (1)(2)(5) — Developing single-crystal aluminum nitride substrates for optoelectronic devices			
Series A Convertible Preferred Stock	(C)	391,571	305,425
Series A-1 Convertible Preferred Stock	(C)	1,300,376	1,014,294
Warrants at \$0.78 expiring 05/05/2013	(B)	15,231	0
Warrants at \$0.78 expiring 05/12/2013	(B)	2,350	0
Warrants at \$0.78 expiring 08/08/2013	(B)	4,396	0
			1,319,719
CSwitch, Inc. (1)(2)(5) — Developing next-generation, system-on-a-chip solutions for communications-based platforms			
Series A-1 Convertible Preferred Stock	(C)	6,700,000	3,350,000

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(6)(8) - 28.20% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 28.20% of net assets (cont.)</b>			
D-Wave Systems, Inc. (1)(2)(4)(5)(13) — Developing high-performance quantum computing systems			
Series B Convertible Preferred Stock	(A)	2,000,000	\$ 1,716,444
Warrants at \$0.85 expiring 10/19/07	(B)	1,800,000	0
			1,716,444
Innovalight, Inc. (1)(2)(4)(5) - Developing renewable energy products enabled by silicon-based nanomaterials			
Series B Convertible Preferred Stock	(A)	16,666,666	2,500,000
Kereos, Inc. (1)(2)(5) — Developing emulsion-based imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Series B Convertible Preferred Stock	(A)	349,092	960,000
Kovio, Inc. (1)(2)(5) — Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(A)	2,500,000	3,000,000
Mersana Therapeutics, Inc. (1)(2)(5)(12) — Developing advanced polymers for drug delivery			
Series A Convertible Preferred Stock	(C)	68,452	136,904
Series B Convertible Preferred Stock	(C)	616,500	1,233,000
Warrants at \$2.00 expiring 10/21/10	(B)	91,625	0
			1,369,904
Metabolon, Inc. (1)(2)(4)(5) - Discovering biomarkers through the use of metabolomics			
Series B Convertible Preferred Stock	(A)	2,173,913	2,500,000

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS**  
**OF DECEMBER 31, 2006**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies</b>			
<b>(6)(8) - 28.20% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 28.20% of net assets (cont.)</b>			
NanoGram Corporation (1)(2)(5) — Developing a broad suite of intellectual property utilizing nanotechnology			
Series I Convertible Preferred Stock	(C)	63,210 \$	64,259
Series II Convertible Preferred Stock	(C)	1,250,904	1,271,670
Series III Convertible Preferred Stock	(C)	1,242,144	1,262,764
			2,598,693
Nanomix, Inc. (1)(2)(5) — Producing nanoelectronic sensors that integrate carbon nanotube electronics with silicon microstructures			
Series C Convertible Preferred Stock	(B)	9,779,181	790,000
NanoOpto Corporation (1)(2)(5) — Manufacturing discrete and integrated optical communications sub-components on a chip by utilizing nano manufacturing and nano coating technology			
Series A-1 Convertible Preferred Stock	(B)	267,857	16,400
Series B Convertible Preferred Stock	(B)	3,819,935	560,328
Series C Convertible Preferred Stock	(B)	1,932,789	425,266
Series D Convertible Preferred Stock	(B)	1,397,218	204,951
Warrants at \$0.4359 expiring 03/15/10	(B)	193,279	0
			1,206,945
Nextreme Thermal Solutions, Inc. (1)(2)(5) — Developing thin-film thermoelectric devices			
Series A Convertible Preferred Stock	(A)	1,000,000	1,000,000
Questech Corporation (1)(2) — Manufacturing and marketing proprietary metal and stone decorative tiles			
Common Stock	(B)	655,454	996,683
Warrants at \$1.50 expiring 11/21/07	(B)	3,750	77
Warrants at \$1.50 expiring 11/19/08	(B)	5,000	103
Warrants at \$1.50 expiring 11/19/09	(B)	5,000	103
			996,966

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

**HARRIS & HARRIS GROUP, INC.  
CONSOLIDATED SCHEDULE OF  
INVESTMENTS AS OF DECEMBER 31, 2006**

	<b>Method of Valuation (3)</b>	<b>Shares/ Principal</b>	<b>Value</b>
<b>Investments in Non-Controlled Affiliated Companies (6)(8) - 28.20% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 28.20% of net assets (cont.)</b>			
Solazyme, Inc. (1)(2)(5) — Developing energy-harvesting machinery of photosynthetic microbes to produce industrial and pharmaceutical molecules			
Series A Convertible Preferred Stock	(C)	988,204	\$ 385,400
Starfire Systems, Inc. (1)(2)(5) — Producing ceramic-forming polymers			
Common Stock	(A)	375,000	150,000
Series A-1 Convertible Preferred Stock	(C)	600,000	600,000
			750,000
Xradia, Inc. (1)(2)(4) - Designing, manufacturing and selling ultra high resolution 3D x-ray microscopes and fluorescence imaging systems.			
Series D Convertible Preferred Stock	(A)	3,121,099	4,000,000
Zia Laser, Inc. (1)(2)(5) — Developing quantum dot semiconductor lasers			
Series C Convertible Preferred Stock	(C)	1,500,000	15,000
<b>Total Non-Controlled Private Placement Portfolio (cost: \$39,571,676)</b>			<b>\$ 32,128,054</b>
<b>Total Investments in Non-Controlled Affiliated Companies (cost: \$39,571,676)</b>			<b>\$ 32,128,054</b>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Controlled Affiliated Companies (6)(9)</b>			
<b>- 3.30% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) - 3.30% of net assets</b>			
Evolved Nanomaterial Sciences, Inc. (1)(2)(4)(5) — Developing nanotechnology-enhanced approaches for the resolution of chiral molecules			
Series A Convertible Preferred Stock	(A)	5,870,021	\$ 2,800,000
SiOnyx, Inc. (1)(2)(4)(5) — Developing silicon-based optoelectronic products enabled by its proprietary, "Black Silicon"			
Series A Convertible Preferred Stock	(C)	233,499	70,050
Series A-1 Convertible Preferred Stock	(C)	2,966,667	890,000
			960,050
<b>Total Controlled Private Placement Portfolio (cost: \$4,440,000)</b>			<b>\$ 3,760,050</b>
<b>Total Investments in Controlled Affiliated Companies (cost: \$4,440,000)</b>			<b>\$ 3,760,050</b>
<b>U.S. Government and Agency Securities - 51.48% of net assets</b>			
U.S. Treasury Bill — due date 1/18/07	(J)	2,217,000	2,212,677
U.S. Treasury Notes — due date 11/30/07, coupon 4.25%	(H)	6,500,000	6,455,345
U.S. Treasury Notes — due date 02/15/08, coupon 3.375%	(H)	9,000,000	8,842,860
U.S. Treasury Notes — due date 05/15/08, coupon 3.75%	(H)	9,000,000	8,862,210
U.S. Treasury Notes — due date 09/15/08, coupon 3.125%	(H)	5,000,000	4,861,350
U.S. Treasury Notes — due date 01/15/09, coupon 3.25%	(H)	3,000,000	2,910,930
U.S. Treasury Notes — due date 02/15/09, coupon 4.50%	(H)	5,100,000	5,069,145
U.S. Treasury Notes — due date 04/15/09, coupon 3.125%	(H)	3,000,000	2,893,830
U.S. Treasury Notes — due date 07/15/09, coupon 3.625%	(H)	3,000,000	2,920,890
U.S. Treasury Notes — due date 10/15/09, coupon 3.375%	(H)	3,000,000	2,894,310
U.S. Treasury Notes — due date 01/15/10, coupon 3.625%	(H)	3,000,000	2,907,420
U.S. Treasury Notes — due date 04/15/10, coupon 4.00%	(H)	3,000,000	2,935,560
U.S. Treasury Notes — due date 07/15/10, coupon 3.875%	(H)	3,000,000	2,920,560
U.S. Treasury Notes — due date 10/15/10, coupon 4.25%	(H)	2,000,000	1,969,060
<b>Total Investments in U.S. Government and Agency Securities (cost: \$59,212,598)</b>			<b>\$ 58,656,147</b>
<b>Total Investments (cost: \$121,331,398)</b>			<b>\$ 112,323,978</b>

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

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**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2006**

Notes to Consolidated Schedule of Investments

- (1) 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.
- (2) Legal restrictions on sale of investment.
- (3) See Footnote to Schedule of Investments for a description of the Valuation Procedures.
- (4) Initial investment was made during 2006.
- (5) 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.
- (6) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company or where we hold one or more seats on the portfolio company's Board of Directors. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company.
- (7) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$18,107,124. The gross unrealized appreciation based on the tax cost for these securities is \$1,732,194. The gross unrealized depreciation based on the tax cost for these securities is \$2,059,591.
- (8) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$39,571,676. The gross unrealized appreciation based on the tax cost for these securities is \$333,269. The gross unrealized depreciation based on the tax cost for these securities is \$7,776,891.
- (9) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$4,400,000. The gross unrealized appreciation based on the tax cost for these securities is \$0. The gross unrealized depreciation based on the tax cost for these securities is \$679,950.
- (10) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.
- (11) BridgeLux, Inc., was previously named eLite Optoelectronics, Inc.
- (12) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.
- (13) 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. Refer to Note 2 "Significant Accounting Policies."

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

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**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2005**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (6)(7) - 13.2% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) - 13.2% of net assets</b>			
AlphaSimplex Group, LLC (2) — Investment management company headed by Dr. Andrew W. Lo, holder of the Harris & Harris Group Chair at MIT Limited Liability Company Interest	(B)	—\$	16,315
Crystal IS, Inc. (1)(2)(5) — Developing a technology to grow single-crystal boules of aluminum nitride for gallium nitride electronics			
Series A Convertible Preferred Stock	(A)	274,100	199,983
Exponential Business Development Company (1)(2) — Venture capital partnership focused on early stage companies			
Limited Partnership Interest	(B)	—	0
Molecular Imprints, Inc. (1)(2) — Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(A)	1,333,333	2,000,000
Series C Convertible Preferred Stock	(A)	1,250,000	2,500,000
Warrants at \$2.00 expiring 12/31/15	(B)	125,000	0
			4,500,000
Nanosys, Inc. (1)(2)(5) — Developing nanotechnology-enabled systems incorporating zero and one-dimensional inorganic nanometer-scale materials			
Series C Convertible Preferred Stock	(C)	803,428	2,370,113
Series D Convertible Preferred Stock	(C)	1,016,950	3,000,003
			5,370,116
Nantero, Inc. (1)(2)(5) — Developing a high-density, nonvolatile, random access memory chip, using nanotechnology			
Series A Convertible Preferred Stock	(C)	345,070	1,046,908
Series B Convertible Preferred Stock	(C)	207,051	628,172
Series C Convertible Preferred Stock	(C)	188,315	571,329
			2,246,409

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

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**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2005**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (6)(7) - 13.2% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 13.2% of net assets (cont.)</b>			
NeoPhotonics Corporation (1)(2) — Developing and manufacturing planar optical devices and components			
Common Stock	(C)	716,195	\$ 67,736
Series 1 Convertible Preferred Stock	(C)	1,831,256	2,014,677
Series 2 Convertible Preferred Stock	(C)	741,898	878,120
Warrants at \$0.15 expiring 01/26/10	(C)	16,364	164
Warrants at \$0.15 expiring 12/05/10	(C)	14,063	140
			2,960,837
Polatis, Inc. (1)(2)(5)(9) — Developing optical networking components by merging materials, MEMS and electronics technologies			
Series A-1 Convertible Preferred Stock	(B)	16,775	47,828
Series A-2 Convertible Preferred Stock	(B)	71,611	204,172
			252,000
<b>Total Unaffiliated Private Placement Portfolio (cost: \$15,469,546)</b>			<b>\$ 15,545,660</b>
<b>Total Investments in Unaffiliated Companies (cost: \$15,469,546)</b>			<b>\$ 15,545,660</b>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2005**

	Method of Valuation (3)	Principal	Shares/ Value
<b>Investments in Non-Controlled Affiliated Companies (6)(8) - 15.0% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) - 15.0% of net assets</b>			
Cambrios Technologies Corporation (1)(2)(5) — Developing commercially relevant materials by evolving biomolecules to express control over nanostructure synthesis			
Series B Convertible Preferred Stock	(A)	1,294,025	\$ 1,294,025
Chlorogen, Inc. (1)(2)(5) — Developing patented chloroplast technology to produce plant-made proteins			
Series A Convertible Preferred Stock	(A)	4,478,038	785,000
Series B Convertible Preferred Stock	(A)	2,077,930	364,261
			1,149,261
CSwitch, Inc. (1)(2)(5) — Developing next-generation, system-on-a-chip solutions for communications-based platforms			
Series A Convertible Preferred Stock	(B)	1,000,000	500,000
eLite Optoelectronics Inc. (1)(2)(4) — Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(A)	1,861,504	1,000,000
Kereos, Inc. (1)(2)(4)(5) — Developing molecular imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Series B Convertible Preferred Stock	(A)	349,092	960,000
Kovio , Inc. (1)(2)(4)(5) — Developing semi-conductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(A)	2,500,000	3,000,000
Mersana Therapeutics, Inc. (1)(2)(5)(10) — Developing advanced polymers for drug delivery			
Series A Convertible Preferred Stock	(C)	68,452	136,904

Series B Convertible Preferred Stock	(C)	616,500	1,233,000
Warrants at \$2.00 expiring 10/21/10	(B)	91,625	0
			1,369,904

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

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**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2005**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies (6)(8) - 15.0% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 15.0% of net assets (cont.)</b>			
NanoGram Corporation (1)(2)(5) — Developing a broad suite of intellectual property utilizing nanotechnology			
Series I Convertible Preferred Stock	(B)	63,210	\$ 64,259
Series II Convertible Preferred Stock	(B)	1,250,904	1,271,670
			1,335,929
Nanomix, Inc. (1)(2)(5) — Producing nanoelectronic sensors that integrate carbon nanotube electronics with silicon microstructures			
Series C Convertible Preferred Stock	(A)	9,779,181	2,500,000
NanoOpto Corporation (1)(2)(5) — Manufacturing discrete and integrated optical communications sub-components on a chip by utilizing nano-manufacturing technology			
Series A-1 Convertible Preferred Stock	(C)	267,857	32,490
Series B Convertible Preferred Stock	(C)	3,819,935	1,110,073
Series C Convertible Preferred Stock	(C)	1,932,789	842,503
Warrants at \$0.4359 expiring 03/15/10	(C)	193,279	0
			1,985,066
Nextreme Thermal Solutions, Inc. (1)(2)(5) — Developing thin-film, superlattice thermoelectric devices			
Series A Convertible Preferred Stock	(A)	500,000	500,000
Questech Corporation (1)(2) — Manufacturing and markets proprietary metal decorative tiles			
Common Stock	(C)	646,954	724,588
Warrants at \$1.50 expiring 08/03/06	(B)	8,500	0
Warrants at \$1.50 expiring 11/21/07	(B)	3,750	0
Warrants at \$1.50 expiring 11/19/08	(B)	5,000	0
Warrants at \$1.50 expiring 11/19/09	(B)	5,000	0
			724,588

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

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**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2005**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies (6)(8) - 15.0% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 15.0% of net assets (cont.)</b>			
Solazyme, Inc. (1)(2)(5) — Developing energy-harvesting machinery of photosynthetic microbes to produce industrial and pharmaceutical molecules			
Series A Convertible Preferred Stock	(C)	988,204	\$ 385,400
Starfire Systems, Inc. (1)(2)(5) —Producing ceramic-forming polymers			
Common Stock	(A)	375,000	150,000
Series A-1 Convertible Preferred Stock	(A)	600,000	600,000
			750,000
Zia Laser, Inc. (1)(2)(4)(5) — Developing quantum dot semiconductor lasers			
Series C Convertible Preferred Stock	(B)	1,500,000	187,500
<b>Total Non-Controlled Private Placement Portfolio (cost: \$22,236,796)</b>			<b>\$ 17,641,673</b>
<b>Total Investments in Non-Controlled Affiliated Companies (cost: \$22,236,796)</b>			<b>\$ 17,641,673</b>
<b>U.S. Government and Agency Securities - 81.5% of net assets</b>			
U.S. Treasury Bills — due date 01/05/06	(J)	24,500,000	\$ 24,495,590
U.S. Treasury Notes — due date 02/28/06, coupon 1.625%	(H)	810,000	806,963
U.S. Treasury Bills — due date 03/02/06	(J)	32,845,000	32,640,376
U.S. Treasury Bills — due date 03/16/06	(J)	4,750,000	4,712,855
U.S. Treasury Notes — due date 03/31/06, coupon 1.5%	(H)	4,616,000	4,586,965
U.S. Treasury Notes — due date 11/30/07, coupon 4.25%	(H)	6,500,000	6,480,955
U.S. Treasury Notes — due date 02/15/08, coupon 3.375%	(H)	9,000,000	8,814,690
U.S. Treasury Notes — due date 05/15/08, coupon 3.75%	(H)	9,000,000	8,872,020
U.S. Treasury Notes — due date 09/15/08, coupon 3.125%	(H)	5,000,000	4,840,450
<b>Total Investments in U.S. Government and Agency Securities (cost: \$96,320,405)</b>			<b>\$ 96,250,864</b>



**Total Investments (cost: \$134,026,747)** **\$ 129,438,197**

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

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**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2005**

Notes to Consolidated Schedule of Investments

- (1) 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.
- (2) Legal restrictions on sale of investment.
- (3) See Footnote to Schedule of Investments for a description of the Valuation Procedures.
- (4) Initial investment was made during 2005.
- (5) 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.
- (6) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company or where we hold one or more seats on the portfolio company's Board of Directors. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company.
- (7) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$15,469,546. The gross unrealized appreciation based on the tax cost for these securities is \$1,732,194. The gross unrealized depreciation based on the tax cost for these securities is \$1,656,080.
- (8) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$22,236,796. The gross unrealized appreciation based on the tax cost for these securities is \$313,534. The gross unrealized depreciation based on the tax cost for these securities is \$4,908,657.
- (9) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.
- (10) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.

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

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

**VALUATION PROCEDURES**

Our investments can be classified into five broad categories for valuation purposes:

- Equity-Related Securities;
- Investments in Intellectual Property or Patents or Research and Development in Technology or Product Development;
- Long-Term Fixed-Income Securities;
- Short-Term Fixed-Income Investments; and
- All Other Investments.

The 1940 Act requires periodic valuation of each investment in our portfolio to determine 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.

Our Board of Directors is responsible for (1) determining overall valuation guidelines and (2) ensuring the valuation of investments within the prescribed guidelines.

Our Valuation Committee, comprised of three or more independent Board members, is responsible for reviewing and approving the valuation of our assets within the guidelines established by the Board of Directors.

Fair value is generally defined as the amount that an investment could be sold for in an orderly disposition over a reasonable time. Generally, to increase objectivity in valuing our assets, external measures of value, such as public markets or third-party transactions, are utilized whenever possible. Valuation is not based on long-term work-out value, nor immediate liquidation value, nor incremental value for potential changes that may take place in the future.

The values assigned to these investments 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 reasonably be determined until the individual investments are actually liquidated or become marketable.

Our valuation policy with respect to the five broad investment categories is as follows:

**Equity-Related Securities**

Equity-related securities are valued using one or more of the following basic methods of valuation:

**A. Cost.** The cost method is based on our original cost. This method is generally used in the early stages of a company's development until significant positive or negative events occur subsequent to the date of the original investment that dictate a change to another valuation method. Some examples of these events are: (1) a major recapitalization; (2) a major refinancing; (3) a significant third-party transaction; (4) the development of a meaningful public market for the company's common stock; and (5) significant positive or negative changes in a company's business.

**B. Analytical Method.** The analytical method is generally used to value an investment position when there is no established public or private market in the company's securities or when the factual information available to us dictates that an investment should no longer be valued under either the cost or private market method. This valuation method is inherently imprecise and ultimately the result of reconciling the judgments of our Valuation Committee members, based on the data available to them. The resulting valuation, although stated as a precise number, is necessarily within a range of values that vary depending upon the significance attributed to the various factors being considered. Some of the factors considered may include the financial condition and operating results of the company, the long-term potential of the business of the company, the values of similar securities issued by companies in similar businesses, 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.

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**C. Private Market.** The private market method uses actual, executed, historical transactions in a company's securities by responsible third parties as a basis for valuation. The private market method may also use, where applicable, unconditional firm offers by responsible third parties as a basis for valuation.

**D. Public Market.** The public market method is used when there is an established public market for the class of the company's securities held by us or into which our securities are convertible. We discount market value for securities that are subject to significant legal and contractual restrictions. Other securities, for which market quotations are readily available, are carried at market value as of the time of valuation. Market value for securities traded on securities exchanges or on the Nasdaq Global Market is the last reported sales price on the day of valuation. For other securities traded in the over-the-counter market and listed securities for which no sale was reported on that day, market value is the mean of the closing bid price and asked price on that day. This method is the preferred method of valuation when there is an established public market for a company's securities, as that market provides the most objective basis for valuation.

### **Investments in Intellectual Property or Patents or Research and Development in Technology or Product Development**

These investments are carried at fair value using the following basic methods of valuation:

**E. Cost.** The cost method is based on our original cost. This method is generally used in the early stages of commercializing or developing intellectual property or patents or research and development in technology or product development until significant positive or adverse events occur subsequent to the date of the original investment that dictate a change to another valuation method.

**F. Analytical Method.** The analytical method is used to value an investment after analysis of the best available outside information where the factual information available to us dictates that an investment should no longer be valued under either the cost or private market method. This valuation method is inherently imprecise and ultimately the result of reconciling the judgments of our Valuation Committee members. The resulting valuation, although stated as a precise number, is necessarily within a range of values that vary depending upon the significance attributed to the various factors being considered. Some of the factors considered may include the results of research and development, product development progress, commercial prospects, term of patent and projected markets.

**G. Private Market.** The private market method uses actual third-party investments in intellectual property or patents or research and development in technology or product development as a basis for valuation, using actual executed historical transactions by responsible third parties. The private market method may also use, where applicable, unconditional firm offers by responsible third parties as a basis for valuation.

As of December 31, 2006, we do not have any investments in intellectual property or patents or research and development in technologies or products.

### **Long-Term Fixed-Income Securities**

**H. Readily Marketable.** Fixed-income securities for which market quotations are readily available are carried at market value as of the time of valuation using the most recent bid quotations when available.

**I. Not Readily Marketable.** Securities for which market quotations are not readily available are carried at fair value using one or more of the following basic methods of valuation:

- Fixed-income securities are valued by independent pricing services that provide market quotations based primarily on quotations from dealers and brokers, market transactions, and other sources.
- Other fixed-income securities that are not readily marketable are valued at fair value by our Valuation Committee.

#### **Short-Term Fixed-Income Investments**

**J.** Short-term fixed-income investments are valued at market value at the time of valuation. We value short-term debt with remaining maturity of 60 days or less at amortized cost.

#### **All Other Investments**

**K.** All other investments are reported at fair value as determined in good faith by the Valuation Committee. As of December 31, 2006, we do not have any of these investments.

The reported values of securities for which market quotations are not readily available and for other assets reflect the Valuation Committee's judgment of fair values as of the valuation date using the outlined basic methods of valuation. They do not necessarily represent an amount of money that would be realized if we had to sell the securities in an immediate liquidation. Thus, valuations as of any particular date are not necessarily indicative of amounts that we may ultimately realize as a result of future sales or other dispositions of investments we hold.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### **NOTE 1. THE COMPANY**

Harris & Harris Group, Inc. (the "Company," "us," "our" and "we"), is a venture capital company operating as a business development company ("BDC") under the Investment Company Act of 1940 ("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 governmental 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 and Exchange Act of 1934 as an operating company and, while an operating company, operated directly and through subsidiaries.

Harris & Harris Enterprises, Inc.<sup>SM</sup> ("Enterprises"), is a 100 percent wholly owned subsidiary of the Company. Enterprises is a partner in Harris Partners I, L.P.<sup>SM</sup> and is taxed under Subchapter C of the Code (a "C Corporation"). Harris Partners I, L.P. is a limited partnership and owns our interest in AlphaSimplex Group, LLC. The partners of Harris Partners I, L.P., are Enterprises (sole general partner) and Harris & Harris Group, Inc. (sole limited partner).

We filed for the 1999 tax year to elect treatment as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986 (the "Code") and qualified for the same treatment for the years 2000 through 2005. However, there can be no assurance that we will qualify as a RIC for 2006 or subsequent years. In addition, under certain circumstances, even if we qualified for Subchapter M treatment for 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. As a RIC, we must, among other things, distribute at least 90 percent of our investment company taxable income and may either distribute or retain our realized net capital gains on investments.

### **NOTE 2. 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 accounting principles generally accepted in the United States of America for investment companies and include the accounts of the Company and its wholly owned subsidiaries. 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 accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities as of December 31, 2006 and December 31, 2005, and the reported amounts of revenues and expenses for the twelve months ended December 31, 2006, 2005 and 2004. The most significant estimates relate to the fair valuations of certain of our investments. Actual results could differ from these estimates.

**Cash and Cash Equivalents.** Cash and cash equivalents include money market instruments with maturities of less than three months.

Portfolio Investment Valuations. 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.") At December 31, 2006, our financial statements include private venture capital investments valued at \$53,667,831 the fair values of which 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.

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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. At December 31, 2006, included in the unrealized loss on investments was \$34,103 resulting from foreign currency translation.

Securities Transactions. Securities transactions are accounted for on the date the securities are purchased or sold (trade date); dividend income is recorded on the ex-dividend date; and interest income is accrued as earned. The Company ceases accruing interest when securities are determined to be non-income producing and writes off any previously accrued interest. Realized gains and losses on investment transactions are determined by specific identification for financial reporting and tax reporting.

Stock-Based Compensation. The Company has a stock-based employee compensation plan. The Company accounts for the plan in accordance with the provisions of SFAS No. 123(R), "Share-Based Payment." See Note 3 for further discussion.

Income Taxes. Prior to our conversion to a RIC in 1999, our taxes were accounted for in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109.

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

Restricted Funds. The Company maintains 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.

Property and Equipment. Property and equipment are included in "Other Assets" and are carried at cost, less accumulated depreciation of \$274,566. Depreciation is provided using the straight-line method over the estimated useful lives of the premises and equipment.

Recent Accounting Pronouncements. In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes," and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on subsequent de-recognition of tax positions, financial statement classification, recognition of interest and penalties, accounting in interim periods, and disclosure and transition requirements. FIN 48 is effective for the Company's fiscal year beginning January 1, 2007, with early adoption permitted. The Company is in the process of evaluating FIN 48.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for the Company's fiscal year beginning January 1, 2008, with early adoption permitted. The Company is in the process of evaluating SFAS No. 157.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("SFAS No. 158"). SFAS No. 158 requires an employer that sponsors one or more single-employer defined benefit plans and other postretirement benefit plans to (a) recognize the over-funded or under-funded status of their benefit plans in its

statement of financial position, (b) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to SFAS No. 87, "Employers' Accounting for Pensions," or SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," (c) measure the fair value of plan assets and obligations as of the date of the employer's fiscal year-end and (d) disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The Company adopted SFAS No. 158 effective December 31, 2006, which had the effect of increasing net assets and accrued liabilities by \$61,527. See Note 6 for further discussion of the effects of adopting SFAS No. 158 on the Company's consolidated financial statements.

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**NOTE 3. STOCK-BASED COMPENSATION**

On March 23, 2006, the Board of Directors of the Company voted to terminate the Employee Profit-Sharing Plan and establish the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan"), subject to shareholder approval. This proposal was approved at the May 4, 2006 Annual Meeting of Shareholders. The Stock Plan provides for the grant of equity-based awards of stock options and restricted stock (subject to receipt of an exemption order described below) to our directors, officers and employees who are selected by our Compensation Committee for participation in the plan and subject to compliance with the 1940 Act.

On July 11, 2006, the Company filed an application with the SEC regarding certain provisions of the Stock Plan. In the event that the SEC provides the exemptive relief requested by the application and any additional stockholder approval required by the SEC, the Compensation Committee may, in the future, authorize awards under the Stock Plan to certain former officers of the Company, non-employee directors of the Company, authorize grants of restricted stock and adjust the exercise price of options to reflect taxes paid for deemed dividends.

A maximum of 20 percent of our total shares of our common stock issued and outstanding are available for awards under the Stock Plan. Under the Stock Plan, no more than 25 percent of the shares of stock reserved for the grant of the awards under the Stock Plan may be restricted stock awards at any time during the term of the Stock Plan. If any shares of restricted stock are awarded, such awards will reduce on a percentage basis the total number of shares of stock for which options may be awarded. If the Company does not receive exemptive relief from the SEC to issue restricted stock, all shares granted under the Stock Plan may be subject to stock options.

If the Company does receive such exemptive relief and issues 25 percent of the shares of stock reserved for grant under the Stock Plan as restricted stock, no more than 75 percent of the shares granted under the Stock Plan may be subject to stock options. No more than 1,000,000 shares of our common stock may be made subject to awards under the Stock Plan to any individual in any year.

On June 26, 2006, the Compensation Committee of the Board of Directors of the Company approved individual stock option awards for certain officers and employees of the Company. Both non-qualified stock options ("NQSOs") and incentive stock options ("ISOs"), subject to the limitations of Section 422 of the Internal Revenue Code, were awarded under the Stock Plan. The terms and conditions of the stock options granted were determined by the Compensation Committee and set forth in award agreements between the Company and each award recipient. A total of 3,958,283 stock options were granted with vesting periods ranging from December 2006 to June 2014 and with an exercise price of \$10.11. Upon exercise, the shares will be issued from our previously authorized shares. The full Board of Directors ratified and approved the grants on August 3, 2006, on which date the Company's common stock price fluctuated between \$9.76 and \$10.00.

The Company accounts for the Stock Plan in accordance with the provisions of SFAS No. 123(R), "Share-Based Payment," which requires that we determine 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 December 31, 2006, 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 intends to qualify as a RIC under Subchapter M of the Code.

The fair value of each stock option award is estimated on the date of grant using the Black-Scholes option pricing model as permitted by SFAS No. 123(R). The stock options were awarded in five different grant types, each with different contractual terms. The assumptions used in the calculation of fair value using the Black-Scholes model for each contract term were 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	1 Year	1,001,017	0.75	37.4%	0%	5.16%	\$ 1.48
Non-qualified stock options	2 Years	815,000	1.625	45.2%	0%	5.12%	\$ 2.63
Non-qualified stock options	3 Years	659,460	2.42	55.7%	0%	5.09%	\$ 3.81
Non-qualified stock options	10 Years	690,000	5.75	75.6%	0%	5.08%	\$ 6.94
Incentive stock options	10 Years	792,806	7.03	75.6%	0%	5.08%	\$ 7.46
<b>Total</b>		<b>3,958,283</b>					<b>\$ 4.25</b>

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 compensation cost will also increase. The expected term assumption is generally calculated using historical stock option exercise data. The Company does not have historical exercise data to develop such an assumption. 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 terms 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. Expected volatility factors for the stock options were based on the historical fluctuations in the Company's stock price over the expected term of the option, adjusted for stock splits and dividends.

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 option 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 0 percent.

The risk-free interest rate assumptions are 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. Higher assumed interest rates yield higher fair values.

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The amount of 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 forfeitures that occur before vesting. 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.

For the twelve months ended December 31, 2006, the Company recognized \$5,038,956 of compensation expense in the Consolidated Statements of Operations. As of December 31, 2006, there was approximately \$10,544,535 of unrecognized compensation cost related to unvested stock option awards. This cost is expected to be recognized over a weighted-average period of approximately 1.75 years.

For the twelve months ended December 31, 2006, a total of 258,672 shares were exercised for total proceeds to the Company of \$2,615,190. At December 31, 2006, the Company had a broker receivable totaling \$819,905 for proceeds from stock option exercises transacted on December 29, 2006. The Company received these proceeds on January 3, 2007.

For the twelve months ended December 31, 2006, the calculation of the net decrease in net assets resulting from operations per share excludes the stock options because such options were anti-dilutive. The 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 or significant decreases in the amount of unrecognized compensation cost.

A summary of the changes in outstanding stock options 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 June 1, 2006	-				
Granted	3,958,283	\$ 10.11	\$ 4.25		
Exercised	258,672	\$ 10.11	\$ 1.79		\$ 512,171
Forfeited or Expired	-				
Options Outstanding at December 31, 2006	3,699,611	\$ 10.11	\$ 4.43	4.64	\$ 7,325,230
Options Exercisable at December 31, 2006	1,067,029	\$ 10.11	\$ 3.11	3.11	\$ 2,112,717
Options Exercisable and Expected to be Exercisable at December 31, 2006	3,531,996	\$ 10.11	\$ 4.28	4.41	\$ 6,993,352

The aggregate intrinsic value in the table above is calculated as the difference between the Company's closing stock price of \$12.09 on the last trading day of 2006 and the exercise price, multiplied by the number of in-the-money options. This represents the total pre-tax intrinsic value that would have been received by the option holders had all option holders fully vested and exercised their awards on December 31, 2006.

Unless earlier terminated by our Board of Directors, the Stock Plan will expire on May 4, 2016. The expiration of the Stock Plan will not by itself adversely affect the rights of plan participants under awards that are outstanding at the time the Stock Plan expires. Our Board of Directors may terminate, modify or suspend the plan at any time, provided that no modification of the plan will be effective unless and until any required shareholder approval has been obtained. The Compensation Committee may terminate, modify or amend any outstanding award under the Stock Plan at any

time, provided that in such event, the award holder may exercise any vested options prior to such termination of the Stock Plan or award.

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#### **NOTE 4. EMPLOYEE PROFIT-SHARING PLAN**

Prior to the adoption of the Stock Plan, the Company operated the Amended and Restated Harris & Harris Group, Inc. Employee Profit-Sharing Plan (the "2002 Plan"). Effective May 4, 2006, the 2002 Plan was terminated.

The 2002 Plan (and its predecessor) provided for profit sharing by our officers and employees equal to 20 percent of our "qualifying income" for that plan year.

As soon as practicable following the year-end, the Compensation Committee determined whether, and if so how much, qualifying income existed for a plan year. Approximately, ninety percent of the amount determined by the Compensation Committee was then paid out to Plan participants pursuant to the distribution percentages set forth in the 2002 Plan. The remaining payment was paid out after we finalized our tax returns for that plan year.

Each quarter, we performed a calculation to determine the accrual for profit sharing. We calculated 20 percent of qualifying income (i.e., realized income) pursuant to the terms of the 2002 Plan and estimated the amount of additional qualifying income, if any, that would result from selling all the portfolio investments that were valued above cost (i.e., that were in an unrealized appreciation position). Although the accrual would fluctuate as a result of changes in qualifying income and changes in unrealized appreciation, payments were made only to the extent that qualifying income existed. At December 31, 2006, and December 31, 2005, we accrued \$261,661 and \$2,107,858, respectively, for profit sharing. On March 1, 2006, the Company paid \$1,897,072 to plan participants (employees and former employees), which represented approximately 90 percent of the total estimated profit-sharing payment for 2005. The Company recorded \$50,875 of expense for the twelve months ended December 31, 2006, based on updated estimates of its ultimate tax liability for 2005. The balance of \$261,661 was paid on January 31, 2007, upon finalization of our tax returns.

As discussed in Note 3, subject to receiving exemptive relief from the SEC, the Company may permit certain former officers of the Company to be participants of the Stock Plan. Alternatively, the SEC may provide relief which would permit us to pay out the remainder, if any, of the former officers' grandfathered participations under the terminated 2002 Plan.

#### **NOTE 5. DISTRIBUTABLE EARNINGS**

As of December 31, 2006, December 31, 2005, and December 31, 2004, there were no distributable earnings. The difference between the book basis and tax basis components of distributable earnings is primarily nondeductible deferred compensation and net operating losses.

On December 20, 2005, the Company declared a designated undistributed capital gain dividend ("deemed dividend") for shareholders of record as of December 31, 2005. The deemed dividend for 2005 was \$23,206,763. See Note 7. "Income Taxes." The Company did not declare dividends for the years ended December 31, 2006, or December 31, 2004.

#### **NOTE 6. EMPLOYEE BENEFITS**

##### **Employment Agreement with CEO**

On October 19, 1999, Charles E. Harris signed an employment agreement with us, which superseded an employment agreement that was about to expire on December 31, 1999. The agreement was to terminate on December 31, 2004 (the "Term"); provided, on January 1, 2000, and on each day thereafter, the Term extends automatically by one day unless at any time we or Mr. Harris, by written notice, decide not to extend the Term, in which case the Term will expire five years from the date of the written notice. On October 14, 2004, Mr. Harris signed an Amended and



Restated Employment Agreement with us (the "Employment Agreement") for the purpose of changing the termination date to be consistent with his retirement date under the Company's Executive Mandatory Retirement Benefit Plan. The Employment Agreement provides that the term of Mr. Harris's employment may not be extended beyond December 31, 2008, unless a committee of the Board consisting of non-interested Directors extends the date by one year pursuant to the Executive Mandatory Retirement Benefit Plan, and Mr. Harris agrees to serve beyond December 31, 2008.

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During the period of employment, Mr. Harris shall serve as our Chairman and Chief Executive Officer; be responsible for the general management of our affairs and all our subsidiaries, reporting directly to our Board of Directors; serve as a member of the Board for the period of which he is and shall from time to time be elected or reelected; and serve, if elected, as an officer and director of any subsidiary or affiliate of us.

Mr. Harris is to receive compensation under his Employment Agreement in the form of base salary, with automatic yearly adjustments to reflect inflation. In addition, the Board may increase such salary, and consequently decrease it, but not below the level provided for by the automatic adjustments described above.

In 2006, the base salary of Mr. Harris was increased from \$246,651, the amount due to him for 2006 pursuant to his Employment Agreement, to \$300,000 (thereby also increasing his SERP benefit) in part in recognition of a 74 percent decrease in Mr. Harris's profit-sharing allocation in recent years in order to provide additional profit sharing to other employees. This was the first salary increase for Mr. Harris, other than cost of living adjustments, since 1994. Mr. Harris's base salary for 2007 was increased to \$306,187 based on a cost of living adjustment.

Mr. Harris is also entitled to participate in our Profit-Sharing Plan as well as in all compensation or employee benefit plans or programs, and to receive all benefits, perquisites, and emoluments for which salaried employees are eligible. Under the Employment Agreement, we furnish Mr. Harris with certain perquisites which include a company car, a personal trainer, membership in certain clubs and up to a \$5,000 annual reimbursement for personal, financial or tax advice, adjusted for inflation.

The Employment Agreement provides Mr. Harris with life insurance for the benefit of his designated beneficiaries in the amount of \$2,000,000; provides reimbursement for uninsured medical expenses, not to exceed \$10,000 per annum, adjusted for inflation, over the period of the contract; provides Mr. Harris and his spouse with long-term care insurance; and with disability insurance in the amount of 100 percent of his base salary. These benefits are for the term of the Employment Agreement.

The Employment Agreement provides severance pay in the event of termination without cause or by constructive discharge and also provides for certain death benefits payable to the surviving spouse equal to the executive's base salary for a period of two years.

In addition, Mr. Harris is entitled to receive severance pay pursuant to the severance compensation agreement that he entered into with us, effective August 15, 1990. The severance compensation agreement provides that if, following a change in our control, as defined in the agreement, his employment is terminated by us without cause or by the executive within one year of such change in control, he shall be entitled to receive compensation in a lump sum payment equal to 2.99 times his average annualized compensation and payment of other welfare benefits. If Mr. Harris's termination is without cause or is a constructive discharge, the amount payable under the Employment Agreement will be reduced by the amounts paid pursuant to the severance compensation agreement.

### **SERP**

The Employment Agreement provides that we adopt a supplemental executive retirement plan (the "SERP") for the benefit of Mr. Harris. Under the SERP, we will cause an amount equal to one-twelfth of Mr. Harris's current annual salary to be credited each month (a "Monthly Credit") to a special account maintained for this purpose on our books for the benefit of Mr. Harris (the "SERP Account"). The amounts credited to the SERP Account are deemed invested or reinvested in such investments as determined by Mr. Harris. The SERP Account is credited and debited to reflect the deemed investment returns, losses and expenses attributed to such deemed investments and reinvestments. Mr. Harris's benefit under the SERP equals the balance in the SERP Account and such benefit will always be 100 percent vested (i.e., not forfeitable). In 2005, Mr. Harris received a \$125,000 distribution from the SERP Account. The balance in the SERP Account will be distributed to Mr. Harris in a lump sum on December 31, 2008; provided,

however, in the event of the termination of his employment, the balance in the SERP Account will be distributed to Mr. Harris or his beneficiary, as the case may be, in a lump-sum payment within 30 days of such termination. The obligations incurred by us under the SERP, which amounted to \$2,149,785 and \$1,730,434 at December 31, 2006 and 2005, respectively, are included in accounts payable and accrued liabilities. We have established a rabbi trust for the purpose of accumulating funds to satisfy such obligations which are reflected as restricted funds on the accompanying consolidated balance sheets. Mr. Harris's rights to benefits pursuant to this SERP will be no greater than those of a general creditor of us.

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**401(k) Plan**

As of January 1, 1989, we adopted an employee benefits program covering substantially all of our employees under a 401(k) Plan and Trust Agreement. As of January 1, 1999, we adopted the Harris & Harris Pension Plan and Trust, a money purchase plan that would allow us to stay compliant with the 401(k) top-heavy regulations and deduction limitation regulations. In 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act of 2001, which has increased the deduction limits for plans such as the 401(k) Plan. This Act eliminated the need for us to maintain two separate plans. Effective December 31, 2001, the Pension Plan merged into the 401(k) Plan, with the 401(k) Plan being the surviving plan. Matching contributions to the plan are at the discretion of the Compensation Committee. For the year ended December 31, 2006, the Compensation Committee approved a 100 percent match which amounted to \$155,000. The 401(k) Company match for the years ended December 31, 2005 and 2004 was \$119,360 and \$99,249, respectively.

**Retiree Medical Benefit Plan**

On June 30, 1994, we adopted a plan to provide medical and dental insurance for retirees, their spouses and dependents who, at the time of their retirement, have ten years of service with us and have attained 50 years of age or have attained 45 years of age and have 15 years of service with us. On February 10, 1997, we amended this plan to include employees who "have seven full years of service and have attained 58 years of age." On November 3, 2005, we amended this plan to reverse the 1997 amendment for future retirees and to remove dependents other than spouses from the plan. The coverage is secondary to any government or subsequent employer provided health insurance plans. The annual premium cost to us with respect to the entitled retiree shall not exceed \$12,000, subject to an index for inflation. On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The Act, which went into effect January 1, 2006, provides a 28 percent subsidy for post-65 prescription drug benefits. Our liability assumes our plan is actuarially equivalent under the Act.

The plan is unfunded and has no assets. The following disclosures about changes in the benefit obligation under our plan to provide medical and dental insurance for retirees are as of the measurement date of December 31:

	<b>2006</b>	<b>2005</b>
Accumulated Postretirement Benefit Obligation at Beginning of Year	\$ 675,334	\$ 546,090
Service Cost	79,381	49,990
Interest Cost	33,786	32,573
Actuarial (Gain)/Loss	(84,879)	57,091
Benefits Paid	(6,795)	(10,410)
<b>Accumulated Postretirement Benefit Obligation at End of Year</b>	<b>\$ 696,827</b>	<b>\$ 675,334</b>

In accounting for the plan, the assumption made for the discount rate was 5.75 percent and 5.5 percent for the years ended December 31, 2006, and 2005, respectively. The assumed health care cost trend rates in 2006 were 9 percent grading to 6 percent over three years for medical and 3 percent per year for dental. The assumed health care cost trend rates in 2005 were 10.0 percent grading to 6.0 percent over four years and 3.0 percent for dental. The effect on disclosure information of a one percentage point change in the assumed health care cost trend rate for each future year is shown below.

	<b>1% Decrease in Rates</b>	<b>Assumed Rates</b>	<b>1% Increase in Rates</b>
Aggregated Service and Interest Cost	\$ 93,584	\$ 113,167	\$ 132,289
Accumulated Postretirement Benefit Obligation	\$ 602,552	\$ 696,827	\$ 780,977

The net periodic postretirement benefit cost for the year is determined as the sum of service cost for the year, interest on the accumulated postretirement benefit obligation and amortization of the transition obligation (asset) less previously accrued expenses over the average remaining service period of employees expected to receive plan benefits. The following is the net periodic postretirement benefit cost for the years ended December 31, 2006, 2005, and 2004:

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Service Cost	\$ 79,381	\$ 49,990	\$ 60,788
Interest Cost on Accumulated Postretirement Benefit Obligation	33,786	32,573	26,343
Amortization of Transition Obligation	0	0	0
Amortization of Net (Gain)/Loss	0	0	0
<b>Net Periodic Post Retirement Benefit Cost</b>	<b>\$ 113,167</b>	<b>\$ 82,563</b>	<b>\$ 87,131</b>

The Company estimates the following benefits to be paid in each of the following years:

2007	\$ 16,968
2008	\$ 25,388
2009	\$ 27,093
2010	\$ 24,781
2011	\$ 26,465
2012 through 2016	\$ 162,990

The contribution payable for 2007 is estimated to be \$16,968.

On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS No. 158. SFAS No. 158 required the Company to recognize the funded status of its retirement benefit plans in the December 31, 2006 statement of assets and liabilities with a corresponding adjustment to net assets. The adjustment to net assets at adoption of \$61,527 represents the net unrecognized actuarial gains of \$95,145 applicable to the healthcare benefit plan net of \$33,618 of unrecognized actuarial losses applicable to the Executive Mandatory Retirement Benefit Plan.

Such amounts previously were reflected as a net increase of the plan's funded status in the Company's statement of assets and liabilities pursuant to the provisions of SFAS Nos. 106 and 187. These amounts will be subsequently recognized as net periodic benefit cost pursuant to the Company's historical accounting policy for amortizing such amounts. Further, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods will be recognized as a component of net assets. Those amounts will be subsequently recognized as a component of net periodic benefit cost on the same basis as the amounts recognized at adoption of SFAS No. 158.

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The adoption of SFAS No. 158 had no effect on the Company's consolidated statement of operations for the year ended December 31, 2006, or for any prior period presented.

**Executive Mandatory Retirement Benefit Plan**

On March 20, 2003, in order to begin planning for eventual management succession, the Board of Directors voted to establish the Executive Mandatory Retirement Benefit Plan for individuals who are employed by us in a bona fide executive or high policy making position. There are currently three such individuals that qualify under the plan, Charles E. Harris, the Chairman and Chief Executive Officer, Douglas W. Jamison, the President, Chief Operating Officer and Chief Financial Officer and Mel P. Melsheimer, the former President, Chief Operating Officer and Chief Financial Officer. Under this plan, mandatory retirement will take place effective December 31 of the year in which the eligible individuals attain the age of 65. On an annual basis beginning in the year in which the designated individual attains the age of 65, a committee of the Board consisting of non-interested directors may determine to postpone the mandatory retirement date for that individual for one additional year for our benefit.

Under applicable law prohibiting discrimination in employment on the basis of age, we can impose a mandatory retirement age of 65 for our executives or employees in high policy-making positions only if each employee subject to the mandatory retirement age is entitled to an immediate retirement benefit at retirement age of at least \$44,000 per year. The benefits payable at retirement to Mr. Harris and Mr. Melsheimer under our existing 401(k) plan do not equal this threshold. A plan was established to provide the difference between the benefit required under the age discrimination laws and that provided under our existing plans. At December 31, 2006 and 2005, we had accrued \$347,075 and \$281,656, respectively, for benefits under this plan. At December 31, 2006, \$241,836 was accrued for Mr. Melsheimer and \$105,239 was accrued for Mr. Harris. Currently, there is no accrual for Mr. Jamison. In 2006, the Company recorded an unrecognized loss in net assets of \$33,618 for the Executive Mandatory Retirement Benefit Plan, pursuant to the adoption of SFAS No. 158. The Company also recorded an additional liability of \$33,618. On December 31, 2004, Mr. Melsheimer retired pursuant to the Executive Mandatory Retirement Benefit Plan. His annual benefit under the plan is \$22,915. Mr. Harris's projected mandatory benefit is \$15,458 upon his retirement.

**NOTE 7. INCOME TAXES**

Provided that a proper election is made, a corporation taxable under Subchapter C of the Code or a C Corporation that elects to qualify as a RIC continues to be taxable as a C Corporation on any gains realized within 10 years of its qualification as a RIC (the "Inclusion Period") from sales of assets that were held by the corporation on the effective date of the RIC election ("C Corporation Assets"), to the extent of any gain built into the assets on such date ("Built-In Gain"). If the corporation fails to make a proper election, it is taxable on its Built-In Gain as of the effective date of its RIC election. We had Built-In Gains at the time of our qualification as a RIC and made the election to be taxed on any Built-In Gain realized during the Inclusion Period.

To the extent that we retain capital gains and declare a deemed dividend to shareholders, the dividend is taxable to the shareholders. We would pay tax on behalf of shareholders, at the corporate rate, on the distribution, and the shareholders would receive a tax credit equal to their proportionate share of the tax paid. We took advantage of this rule for 2005. Included in net realized income from investments for the year ended December 31, 2005, were net realized gains before taxes of \$23,862,037, which consisted primarily of a net realized long term capital gain on the sale of our investment in Neurometrix, Inc., offset by realized net long term capital losses on the sales of Agile Materials & Technologies, Inc., Experion Systems, Inc., Nanotechnologies, Inc., and Optiva, Inc. We applied \$140,751 of our capital loss carryforwards and \$501,640 of our pre-1999 loss carryforwards on Built-In Gains to these gains.

In December 2005, we declared a deemed dividend on net taxable realized long-term capital gains of \$23,206,763. The Company recorded a tax payable on its Consolidated Statements of Assets and Liabilities of \$8,122,367 for taxes

payable on behalf of its shareholders. This distribution of \$8,122,367 was also recorded as an income tax expense on the Consolidated Statements of Operations for the year ended December 31, 2005. Shareholders of record at December 31, 2005, received a tax credit of \$0.39131971 per share. The balance of \$15,084,396 was retained by the Company. The Company paid \$8,122,367 of taxes on behalf of its shareholders on January 30, 2006. At December 31, 2005, we had \$1,514,967 accrued for federal and state income taxes payable upon filing of our 2005 tax returns.

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During the twelve months ended December 31, 2006, we paid \$9,378,520 in federal income taxes. At December 31, 2006, we had \$0 accrued for federal, state and local taxes payable by the Company.

We pay federal, state and local taxes on behalf of our wholly owned subsidiary, Harris & Harris Enterprises, Inc., which is taxed as a C Corporation. For the years ended December 31, 2006, 2005 and 2004, our income tax expense (benefit) for Harris & Harris Enterprises, Inc., was \$9,475, (\$6,411) and \$44,509, respectively.

For the years ended December 31, 2006, 2005 and 2004, the Company's income tax (benefit) expense was allocated as follows:

	2006		2005		2004
Investment operations	\$ 0	\$	0	\$	0
Realized income on investments	(227,355)		1,530,881		(44,509)
Taxes paid on behalf of shareholders	0		8,122,367		0
Increase (decrease) in unrealized appreciation on investments	(0)		(1,364,470)		695,126
Total income tax (benefit) expense	\$ (227,355)	\$	8,288,778	\$	650,617

The above tax expense consists of the following:

	2006		2005		2004
Current	\$ (227,355)	\$	9,653,248	\$	(44,509)
Deferred — Federal	0		(1,364,470)		695,126
Total income tax (benefit) expense	\$ (227,355)	\$	8,288,778	\$	650,617

Continued qualification as a RIC requires us to satisfy certain investment asset diversification requirements in future years. Our ability to satisfy those requirements may not be controllable by us. There can be no assurance that we will qualify as a RIC in subsequent years.

#### **NOTE 8. COMMITMENTS**

On April 17, 2003, we signed a seven-year sublease for office space at 111 West 57<sup>th</sup> Street in New York City. On December 17, 2004, we signed a sublease for additional office space at our current location. The subleases expire on April 29, 2010. Total rent expense for our office space in New York City was \$174,625 for 2006, \$171,171 in 2005 and \$130,518 in 2004. Future minimum sublease payments in each of the following years are: 2007 -- \$184,968; 2008 -- \$188,598; 2009 -- \$192,318; and thereafter, for the remaining term -- \$64,301.

#### **NOTE 9. CAPITAL TRANSACTIONS**

In 1998, the Board of Directors approved that effective January 1, 1998, 50 percent of all Directors' fees be used to purchase our common stock from us. However, effective March 1, 1999, the Board of Directors approved that Directors may purchase our common stock in the open market, rather than from us.

Since 1998, we have repurchased a total of 1,859,047 of our shares for a total of \$3,496,388, including commissions and expenses, at an average price of \$1.88 per share. These treasury shares were reduced by the purchases made by the Directors. On July 23, 2002, because of our strategic decision to invest in tiny technology, the Board of Directors reaffirmed its commitment not to authorize the purchase of additional shares of stock in the foreseeable future.

On November 29, 2006, we filed a registration statement with the SEC on Form N-2 with respect to 4,000,000 shares of our common stock. On December 11, 2006, we filed an amended registration statement with the SEC. After the effective date, the common stock may be sold at prices and on terms to be set forth in one or more supplements to the prospectus from time to time.

In September of 2005, we completed the sale of 3,507,500 shares for gross proceeds of \$37,091,813; net proceeds of the offering, after offering costs of \$565,246, were \$36,526,567. We intend to use, and have been using, the net proceeds of the offering to make new investments in tiny technology as well as for follow-on investments in our existing venture capital investments and for working capital.

#### **NOTE 10. OTHER**

At December 31, 2004, we had a total of \$255,486 of funds in escrow as a result of the merger of NanoGram Devices Corporation and a wholly owned subsidiary of Wilson Greatbatch Technologies, Inc. The funds were held for one year, until March 16, 2005, in an interest-bearing escrow account to secure the indemnification obligations of the former stockholders of NanoGram Devices Corporation. During 2004, we set up, by a charge to realized income from investments, a reserve of 100 percent of the \$255,486. On March 16, 2005, we received the entire \$255,486, released the reserve and realized the income.

#### **NOTE 11. SUBSEQUENT EVENTS**

In January 2007, the Company issued 189,990 shares of common stock upon the exercise of employee stock options. The Company received proceeds of \$1,920,799.

On January 31, 2007, the Company paid the final installment of the 2005 profit-sharing balance to participants totaling \$261,661.

On February 2, 2007, we made a \$350,877 follow-on investment in a privately held tiny technology portfolio company.

On February 6, 2007, we made a \$540,000 follow-on investment in a privately held tiny technology portfolio company.

On February 9, 2007, we made a \$500,000 follow-on investment in Solazyme, Inc.

On February 15, 2007, we made a \$268,654 follow-on investment in a privately held tiny technology portfolio company.

On February 20, 2007, we made a \$1,147,826 new investment in a privately held tiny technology portfolio company.

In February 2007, the Company issued 136,022 shares of common stock upon the exercise of employee stock options. The Company received proceeds of \$1,375,180.

Late in the first quarter of 2007, one of our portfolio companies decided to curtail its fund-raising efforts and to move to sell its assets. If this company sold all of its assets, we believe that the aggregate net proceeds to us, if any, for our ownership interest would probably be substantially less than the valuation that we placed on our ownership interest in this company as a going concern at December 31, 2006. At December 31, 2006, we valued our ownership interest in this company at slightly more than one percent of our gross assets.

**NOTE 12. SELECTED QUARTERLY DATA (UNAUDITED)**

	<b>2006</b>			
	<b>1<sup>st</sup> Quarter</b>	<b>2<sup>nd</sup> Quarter</b>	<b>3<sup>rd</sup> Quarter</b>	<b>4<sup>th</sup> Quarter</b>
Total investment income	\$ 804,862	\$ 785,265	\$ 719,619	\$ 719,015
Net operating loss	\$ (767,743)	\$ (693,887)	\$ (2,988,790)	\$ (3,162,515)
Net increase (decrease) in net assets resulting from operations	\$ (1,653,990)	\$ (1,282,997)	\$ (2,588,092)	\$ (6,248,033)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.08)	\$ (0.06)	\$ (0.12)	\$ (0.31)

	<b>2005</b>			
	<b>1<sup>st</sup> Quarter</b>	<b>2<sup>nd</sup> Quarter</b>	<b>3<sup>rd</sup> Quarter</b>	<b>4<sup>th</sup> Quarter</b>
Total investment income	\$ 260,108	\$ 158,717	\$ 315,374	\$ 801,662
Net operating loss	\$ (745,590)	\$ (3,302,094)	\$ (3,273,797)	\$ 1,851,274
Net increase (decrease) in net assets resulting from operations	\$ (2,233,447)	\$ 7,001,847	\$ 7,336,923	\$ (5,388,947)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.13)	\$ 0.41	\$ 0.40	\$ (0.26)

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**HARRIS & HARRIS GROUP, INC.**  
**FINANCIAL HIGHLIGHTS**

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
Per Share Operating Performance			
Net asset value per share, beginning of year	\$ 5.68	\$ 4.33	\$ 2.95
Net operating (loss) income*	(0.37)	(0.30)	(0.22)
Net realized income (loss) on investments*	0.01	0.77	0.06
Net increase (decrease) in unrealized appreciation (depreciation) as a result of sales*		(1.18)	0.06
Net increase (decrease) in unrealized appreciation (depreciation) on investments held*	(0.21)	1.07	(0.03)
Total from investment operations*	(0.57)	0.36	(0.13)
Net increase as a result of stock-based compensation	0.24	0	0
Net increase as a result of proceeds from exercise of options	0.07	0	0
Net increase as a result of stock offering	0	0.99	1.51
Total increase from capital stock transactions	0.31	0.99	1.51
Net asset value per share, end of year	\$ 5.42	\$ 5.68	\$ 4.33
Stock price per share, end of year	\$ 12.09	\$ 13.90	\$ 16.38
Total return based on stock price <sup>(1)</sup>	(13.0)%	(15.1)%	42.1%
<b>Supplemental Data:</b>			
Net assets, end of year	\$ 113,930,303	\$ 117,987,742	\$ 74,744,799
Ratio of expenses to average net assets <sup>(1)</sup>	9.2%	7.5%	7.4%
Ratio of net operating loss to average net assets <sup>(1)</sup>	(6.6)%	(5.8)%	(6.3)%
Cash dividends paid per share	\$ 0.00	\$ 0.00	\$ 0.00
Taxes payable on behalf of shareholders on the deemed dividend per share	\$ 0	\$ 0.39	\$ 0.00
Number of shares outstanding, end of year	21,015,017	20,756,345	17,248,845

\*Based on average shares outstanding.

<sup>(1)</sup>Not annualized.

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

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

**March 31, 2007**  
**(Unaudited)**

**December 31, 2006**

**ASSETS**

Investments, at value (Cost: \$125,055,760 at 3/31/07, \$121,331,398 at 12/31/06)	\$	112,410,877	\$	112,323,978
Cash and cash equivalents		550,452		2,071,788
Restricted funds		2,258,665		2,149,785
Receivable from broker		0		819,905
Interest receivable		563,375		625,372
Prepaid expenses		427,580		10,945
Other assets		297,754		326,817
<b>Total assets</b>	<b>\$</b>	<b>116,508,703</b>	<b>\$</b>	<b>118,328,590</b>

**LIABILITIES & NET ASSETS**

Accounts payable and accrued liabilities	\$	3,906,008	\$	4,115,300
Accrued profit sharing (Note 5)		0		261,661
Deferred rent		19,626		21,326
Current taxes payable		56,767		0
<b>Total liabilities</b>		<b>3,982,401</b>		<b>4,398,287</b>

<b>Net assets</b>	<b>\$</b>	<b>112,526,302</b>	<b>\$</b>	<b>113,930,303</b>
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**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 3/31/07 and 12/31/06; 23,169,769 issued at 3/31/07 and 22,843,757 issued at 12/31/06		231,698		228,438
Additional paid-in capital (Note 8)		134,784,100		129,801,201
Accumulated net realized loss		(6,500,609)		(3,747,912)
Accumulated unrealized depreciation of investments		(12,644,883)		(9,007,420)
Unrecognized net gain on retirement benefit plans		61,527		61,527
Treasury stock, at cost (1,828,740 shares at 3/31/07 and 1,828,740 shares at 12/31/06)		(3,405,531)		(3,405,531)
<b>Net assets</b>	<b>\$</b>	<b>112,526,302</b>	<b>\$</b>	<b>113,930,303</b>
<b>Shares outstanding</b>		<b>21,341,029</b>		<b>21,015,017</b>
<b>Net asset value per outstanding share</b>	<b>\$</b>	<b>5.27</b>	<b>\$</b>	<b>5.42</b>

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

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

	<b>Three Months Ended March 31, 2007</b>	<b>Three Months Ended March 31, 2006</b>
<b>Investment income:</b>		
Interest from:		
Fixed income securities	\$ 652,498	\$ 802,362
Miscellaneous income	0	2,500
<b>Total investment income</b>	<b>652,498</b>	<b>804,862</b>
<b>Expenses:</b>		
Salaries, benefits and stock-based Compensation (Note 4)	2,534,766	786,361
Administration and operations	380,865	322,449
Professional fees	182,195	289,887
Rent	59,507	61,238
Directors' fees and expenses	141,196	85,902
Depreciation	15,313	16,768
Custodian fees	5,774	10,000
<b>Total expenses</b>	<b>3,319,616</b>	<b>1,572,605</b>
<b>Net operating loss</b>	<b>(2,667,118)</b>	<b>(767,743)</b>
<b>Net realized gain (loss) from investments:</b>		
Realized (loss) gain from investments	(674)	11,953
Income tax expense (Note 7)	84,905	9,606
<b>Net realized (loss) gain from investments</b>	<b>(85,579)</b>	<b>2,347</b>
<b>Net realized loss</b>	<b>(2,752,697)</b>	<b>(765,396)</b>
<b>Net increase in unrealized depreciation on investments:</b>		
Change as a result of investment sales	0	0
Change on investments held	(3,637,463)	(888,594)
Change in unrealized depreciation on investments	(3,637,463)	(888,594)
<b>Net increase in unrealized depreciation on investments</b>	<b>(3,637,463)</b>	<b>(888,594)</b>
<b>Net decrease in net assets resulting from operations:</b>		
<b>Total</b>	<b>\$ (6,390,160)</b>	<b>\$ (1,653,990)</b>
<b>Per average basic and diluted outstanding share</b>	<b>\$ (0.30)</b>	<b>\$ (0.08)</b>
<b>Average outstanding shares</b>	<b>21,277,576</b>	<b>20,756,345</b>

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



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

	<b>Three Months Ended March 31, 2007</b>	<b>Three Months Ended March 31, 2006</b>
<b>Cash flows used in operating activities:</b>		
Net decrease in net assets resulting from operations	\$ (6,390,160)	\$ (1,653,990)
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:		
Net realized and unrealized loss on investments	3,638,137	876,641
Depreciation and amortization	(65,730)	(295,811)
Stock-based compensation expense	1,690,181	0
<b>Changes in assets and liabilities:</b>		
Restricted funds	(108,880)	(170,644)
Receivable from portfolio company	0	75,000
Interest receivable	61,997	(316,696)
Receivable from broker	819,905	0
Prepaid expenses	(416,635)	(449,037)
Other assets	(10,191)	0
Accounts payable and accrued liabilities	(209,292)	236,796
Accrued profit sharing	(261,661)	(1,897,072)
Deferred rent	(1,700)	(1,701)
Current income tax liability	80,795	(8,282,830)
<b>Net cash used in operating activities</b>	<b>(1,173,234)</b>	<b>(11,879,344)</b>
<b>Cash flows from investing activities:</b>		
Purchase of short-term investments and marketable securities	(10,952,109)	(67,883,929)
Sale of short-term investments and marketable securities	12,165,656	92,418,871
Investment in private placements and loans	(4,857,357)	(9,412,764)
Proceeds from sale of investments	0	20,688
Purchase of fixed assets	(270)	(5,989)
<b>Net cash (used in) provided by investing activities</b>	<b>(3,644,080)</b>	<b>15,136,877</b>
<b>Cash flows from financing activities:</b>		
Proceeds from stock option exercises (Note 4)	3,295,978	0
<b>Net cash provided by financing activities</b>	<b>3,295,978</b>	<b>0</b>
<b>Net (decrease) increase in cash and cash equivalents:</b>		
Cash and cash equivalents at beginning of the period	2,071,788	1,213,289
Cash and cash equivalents at end of the period	550,452	4,470,822
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>\$ (1,521,336)</b>	<b>\$ 3,257,533</b>

**Supplemental disclosures of cash flow information:**

Income taxes paid	\$	10,252	\$	8,291,973
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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**

	<b>Three Months Ended March 31, 2007 (Unaudited)</b>	<b>Year Ended December 31, 2006</b>
<b>Changes in net assets from operations:</b>		
Net operating loss	\$ (2,667,118)	\$ (7,612,935)
Net realized (loss) gain on investments	(85,579)	258,693
Net increase in unrealized depreciation on investments held	(3,637,463)	(4,418,870)
<b>Net decrease in net assets resulting from operations</b>	<b>(6,390,160)</b>	<b>(11,773,112)</b>
<b>Changes in net assets from capital stock transactions:</b>		
Issuance of common stock upon the exercise of stock options	3,260	2,587
Additional paid-in capital on common stock issued	3,292,718	2,612,603
Stock-based compensation expense	1,690,181	5,038,956
<b>Net increase in net assets resulting from capital stock transactions</b>	<b>4,986,159</b>	<b>7,654,146</b>
<b>Changes in net assets from adoption of SFAS No. 158</b>	<b>0</b>	<b>61,527</b>
<b>Net decrease in net assets</b>	<b>(1,404,001)</b>	<b>(4,057,439)</b>
<b>Net assets:</b>		
Beginning of the period	113,930,303	117,987,742
End of the period	\$ 112,526,302	\$ 113,930,303

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2007**  
**(Unaudited)**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (6)(7) - 15.97% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) - 15.97% of net assets</b>			
AlphaSimplex Group, LLC (2) — Investment management company headed by Dr. Andrew W. Lo, holder of the Harris & Harris Group Chair at MIT Limited Liability Company Interest	(B)	—\$	11,036
Exponential Business Development Company (1)(2) — Venture capital partnership focused on early stage companies Limited Partnership Interest	(B)	—	0
Molecular Imprints, Inc. (1)(2) — Manufacturing nanoimprint lithography capital equipment			
Series B Convertible Preferred Stock	(A)	1,333,333	2,000,000
Series C Convertible Preferred Stock	(A)	1,250,000	2,500,000
Warrants at \$2.00 expiring 12/31/11	(B)	125,000	0
			4,500,000
Nanosys, Inc. (1)(2)(5) —Developing zero and one-dimensional inorganic nanometer-scale materials and devices			
Series C Convertible Preferred Stock	(C)	803,428	2,370,113
Series D Convertible Preferred Stock	(C)	1,016,950	3,000,003
			5,370,116
Nantero, Inc. (1)(2)(5) — Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes			
Series A Convertible Preferred Stock	(C)	345,070	1,046,908
Series B Convertible Preferred Stock	(C)	207,051	628,172
Series C Convertible Preferred Stock	(C)	188,315	571,329
			2,246,409

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2007**  
**(Unaudited)**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Unaffiliated Companies (6)(7) - 15.97% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 15.97% of net assets (cont.)</b>			
NeoPhotonics Corporation (1)(2) — Developing and manufacturing optical devices and components			
Common Stock	(C)	716,195 \$	133,141
Series 1 Convertible Preferred Stock	(C)	1,831,256	1,831,256
Series 2 Convertible Preferred Stock	(C)	741,898	741,898
Series 3 Convertible Preferred Stock	(C)	2,750,000	2,750,000
Warrants at \$0.15 expiring 01/26/10	(C)	16,364	164
Warrants at \$0.15 expiring 12/05/10	(C)	14,063	140
			5,456,599
Polatis, Inc. (1)(2)(5)(10) — Developing MEMS-based optical networking components			
Series A-1 Convertible Preferred Stock	(B)	16,775	0
Series A-2 Convertible Preferred Stock	(B)	71,611	320,282
Series A-4 Convertible Preferred Stock	(B)	4,774	21,353
Series A-5 Convertible Preferred Stock	(B)	5,491	45,127
			386,762
<b>Total Unaffiliated Private Placement Portfolio (cost: \$18,106,450)</b>			<b>\$ 17,970,922</b>
<b>Total Investments in Unaffiliated Companies (cost: \$18,106,450)</b>			<b>\$ 17,970,922</b>

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

**HARRIS & HARRIS GROUP, INC.**  
**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2007**  
**(Unaudited)**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies (6)(8) - 30.39% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) - 30.39% of net assets</b>			
Adesto Technologies Corporation (1)(2)(4)(5) — Developing semiconductor-related products enabled at the nanoscale			
Series A Convertible Preferred Stock	(A)	3,416,149 \$	1,147,826
BridgeLux, Inc. (1)(2)(11) — Manufacturing high-power light emitting diodes			
Series B Convertible Preferred Stock	(A)	1,861,504	1,000,000
Secured Convertible Bridge Note (including interest)	(A)	\$ 350,877	355,398
			1,355,398
Cambrios Technologies Corporation (1)(2)(5) — Developing nanowire-enabled electronic materials for the display industry			
Series B Convertible Preferred Stock	(C)	1,294,025	1,294,025
Series C Convertible Preferred Stock	(C)	1,300,000	1,300,000
			2,594,025
Chlorogen, Inc. (1)(2)(5) — Developing patented chloroplast technology to produce plant-made proteins			
Series A Convertible Preferred Stock	(B)	4,478,038	0
Series B Convertible Preferred Stock	(B)	2,077,930	0
Secured Convertible Bridge Note (including interest)	(B)	\$ 221,438	0
			0
Crystal IS, Inc. (1)(2)(5)— Developing single-crystal aluminum nitride substrates for optoelectronic devices			

Series A Convertible Preferred Stock	(C)	391,571	305,425
Series A-1 Convertible Preferred Stock	(C)	1,300,376	1,014,294
Warrants at \$0.78 expiring 05/05/2013	(B)	15,231	0
Warrants at \$0.78 expiring 05/12/2013	(B)	2,350	0
Warrants at \$0.78 expiring 08/08/2013	(B)	4,396	0
			1,319,719

CSwitch, Inc. (1)(2)(5) — Developing  
next-generation, system-on-  
a-chip solutions for communications-based  
platforms

Series A-1 Convertible Preferred Stock	(C)	6,700,000	3,350,000
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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 MARCH 31, 2007**  
**(Unaudited)**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies (6)(8) - 30.39% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 30.39% of net assets (cont.)</b>			
D-Wave Systems, Inc. (1)(2)(5)(13) — Developing high- performance quantum computing systems			
Series B Convertible Preferred Stock	(A)	2,000,000	\$ 1,734,600
Warrants at \$0.85 expiring 10/19/07	(B)	1,800,000	0
			1,734,600
Innovalight, Inc. (1)(2)(5) - Developing renewable energy products enabled by silicon-based nanomaterials			
Series B Convertible Preferred Stock	(A)	16,666,666	2,500,000
Kereos, Inc. (1)(2)(5) — Developing emulsion-based imaging agents and targeted therapeutics to image and treat cancer and cardiovascular disease			
Series B Convertible Preferred Stock	(A)	545,456	1,500,000
Kovio, Inc. (1)(2)(5) — Developing semiconductor products using printed electronics and thin-film technologies			
Series C Convertible Preferred Stock	(A)	2,500,000	3,000,000
Mersana Therapeutics, Inc. (1)(2)(5)(12) — Developing advanced polymers for drug delivery			
Series A Convertible Preferred Stock	(C)	68,452	136,904
Series B Convertible Preferred Stock	(C)	616,500	1,233,000
Warrants at \$2.00 expiring 10/21/10	(B)	91,625	0
			1,369,904



Metabolon, Inc. (1)(2)(5) - Discovering  
biomarkers through  
the use of metabolomics

Series B Convertible Preferred Stock	(A)	2,173,913	2,500,000
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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 MARCH 31, 2007**  
**(Unaudited)**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies (6)(8) - 30.39% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 30.39% of net assets (cont.)</b>			
NanoGram Corporation (1)(2)(5) — Developing a broad suite of intellectual property utilizing nanoscale materials			
Series I Convertible Preferred Stock	(C)	63,210 \$	64,259
Series II Convertible Preferred Stock	(C)	1,250,904	1,271,670
Series III Convertible Preferred Stock	(C)	1,242,144	1,262,764
			2,598,693
Nanomix, Inc. (1)(2)(5) — Producing nanoelectronic sensors that integrate carbon nanotube electronics with silicon microstructures			
Series C Convertible Preferred Stock	(B)	9,779,181	330,228
NanoOpto Corporation (1)(2)(5) — Manufacturing discrete and integrated optical communications sub-components on a chip by utilizing nano manufacturing and nano coating technology			
Series A-1 Convertible Preferred Stock	(B)	267,857	0
Series B Convertible Preferred Stock	(B)	3,819,935	0
Series C Convertible Preferred Stock	(B)	1,932,789	0
Series D Convertible Preferred Stock	(B)	1,397,218	49,121
Secured Convertible Bridge Note (including interest)	(B)	268,654	537,308
Warrants at \$0.4359 expiring 03/15/10	(B)	193,279	0
			586,429
Nextreme Thermal Solutions, Inc. (1)(2)(5) — Developing thin-film thermoelectric devices for cooling and energy conversion			
Series A Convertible Preferred Stock	(C)	1,750,000	1,750,000

Questech Corporation (1)(2) — Manufacturing and marketing proprietary metal and stone decorative tiles			
Common Stock	(B)	655,454	905,050
Warrants at \$1.50 expiring 11/21/07	(B)	3,750	0
Warrants at \$1.50 expiring 11/19/08	(B)	5,000	0
Warrants at \$1.50 expiring 11/19/09	(B)	5,000	0
			905,050

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 MARCH 31, 2007**  
**(Unaudited)**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Non-Controlled Affiliated Companies (6)(8) - 30.39% of net assets (cont.)</b>			
<b>Private Placement Portfolio (Illiquid) - 30.39% of net assets (cont.)</b>			
Solazyme, Inc. (1)(2)(5) — Developing energy-harvesting machinery of photosynthetic microbes to produce industrial and pharmaceutical molecules			
Series A Convertible Preferred Stock	(C)	988,204 \$	385,400
Series B Convertible Preferred Stock	(C)	495,246	500,000
			885,400
Starfire Systems, Inc. (1)(2)(5) —Producing ceramic-forming polymers			
Common Stock	(A)	375,000	150,000
Series A-1 Convertible Preferred Stock	(C)	600,000	600,000
			750,000
Xradia, Inc. (1)(2) - Designing, manufacturing and selling ultra high resolution 3D x-ray microscopes and fluorescence imaging systems.			
Series D Convertible Preferred Stock	(A)	3,121,099	4,000,000
Zia Laser, Inc. (1)(2)(5) — Developing quantum dot semiconductor lasers			
Series C Convertible Preferred Stock	(B)	1,500,000	15,000
<b>Total Non-Controlled Private Placement Portfolio (cost: \$44,432,534)</b>			<b>\$ 34,192,272</b>
<b>Total Investments in Non-Controlled Affiliated Companies (cost: \$44,432,534)</b>			<b>\$ 34,192,272</b>

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 MARCH 31, 2007**  
**(Unaudited)**

	Method of Valuation (3)	Shares/ Principal	Value
<b>Investments in Controlled Affiliated Companies (6)(9)</b>			
<b>- 2.25% of net assets</b>			
<b>Private Placement Portfolio (Illiquid) - 2.25% of net assets</b>			
Evolved Nanomaterial Sciences, Inc. (1)(2)(5) — Developing nanoscale-enhanced approaches for the resolution of chiral molecules			
Series A Convertible Preferred Stock	(B)	5,870,021	\$ 1,571,719
SiOnyx, Inc. (1)(2)(5) — Developing silicon-based optoelectronic products enabled by its proprietary "Black Silicon"			
Series A Convertible Preferred Stock	(C)	233,499	70,050
Series A-1 Convertible Preferred Stock	(C)	2,966,667	890,000
			960,050
<b>Total Controlled Private Placement Portfolio (cost: \$4,440,000)</b>			<b>\$ 2,531,769</b>
<b>Total Investments in Controlled Affiliated Companies (cost: \$4,440,000)</b>			<b>\$ 2,531,769</b>
<b>U.S. Government and Agency Securities - 51.29% of net assets</b>			
U.S. Treasury Bill — due date 4/12/07	(J)	1,000,000	998,620
U.S. Treasury Notes — due date 11/30/07, coupon 4.25%	(H)	6,500,000	6,468,540
U.S. Treasury Notes — due date 02/15/08, coupon 3.375%	(H)	9,000,000	8,880,120
U.S. Treasury Notes — due date 05/15/08, coupon 3.75%	(H)	9,000,000	8,892,810
U.S. Treasury Notes — due date 09/15/08, coupon 3.125%	(H)	5,000,000	4,886,500
U.S. Treasury Notes — due date 01/15/09, coupon 3.25%	(H)	3,000,000	2,927,940
U.S. Treasury Notes — due date 02/15/09, coupon 4.50%	(H)	5,100,000	5,086,434
U.S. Treasury Notes — due date 04/15/09, coupon 3.125%	(H)	3,000,000	2,914,350
U.S. Treasury Notes — due date 07/15/09, coupon 3.625%	(H)	3,000,000	2,938,470
U.S. Treasury Notes — due date 10/15/09, coupon 3.375%	(H)	3,000,000	2,915,400
U.S. Treasury Notes — due date 01/15/10, coupon 3.625%	(H)	3,000,000	2,927,940
U.S. Treasury Notes — due date 04/15/10, coupon 4.00%	(H)	3,000,000	2,954,070
U.S. Treasury Notes — due date 07/15/10, coupon 3.875%	(H)	3,000,000	2,942,460
U.S. Treasury Notes — due date 10/15/10, coupon 4.25%	(H)	2,000,000	1,982,260

<b>Total Investments in U.S. Government and Agency Securities (cost: \$58,076,776)</b>	<b>\$ 57,715,914</b>
<b>Total Investments (cost: \$125,055,760)</b>	<b>\$ 112,410,877</b>

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 MARCH 31, 2007**  
**(Unaudited)**

Notes to Consolidated Schedule of Investments

- (1) 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.
- (2) Legal restrictions on sale of investment.
- (3) See Footnote to Schedule of Investments for a description of the Valuation Procedures.
- (4) Initial investment was made during 2007.
- (5) 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.
- (6) Investments in unaffiliated companies consist of investments in which we own less than five percent of the voting shares of the portfolio company. Investments in non-controlled affiliated companies consist of investments in which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company or where we hold one or more seats on the portfolio company's Board of Directors. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company.
- (7) The aggregate cost for federal income tax purposes of investments in unaffiliated companies is \$18,106,450. The gross unrealized appreciation based on the tax cost for these securities is \$1,732,194. The gross unrealized depreciation based on the tax cost for these securities is \$1,867,722.
- (8) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated companies is \$44,432,534. The gross unrealized appreciation based on the tax cost for these securities is \$333,269. The gross unrealized depreciation based on the tax cost for these securities is \$10,573,531.
- (9) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$4,440,000. The gross unrealized appreciation based on the tax cost for these securities is \$0. The gross unrealized depreciation based on the tax cost for these securities is \$1,908,231.
- (10) Continuum Photonics, Inc., merged with Polatis, Ltd., to form Polatis, Inc.
- (11) BridgeLux, Inc., was previously named eLite Optoelectronics, Inc.
- (12) Mersana Therapeutics, Inc., was previously named Nanopharma Corp.
- (13) 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. Refer to Note 3 "Significant Accounting Policies."

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



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**HARRIS & HARRIS GROUP, INC.**  
**FOOTNOTE TO CONSOLIDATED SCHEDULE OF INVESTMENTS**  
**(Unaudited)**

**VALUATION PROCEDURES**

Our investments can be classified into five broad categories for valuation purposes:

- Equity-Related Securities;
- Investments in Intellectual Property or Patents or Research and Development in Technology or Product Development;
- Long-Term Fixed-Income Securities;
- Short-Term Fixed-Income Investments; and
- All Other Investments.

The 1940 Act requires periodic valuation of each investment in our portfolio to determine 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.

Our Board of Directors is responsible for (1) determining overall valuation guidelines and (2) ensuring the valuation of investments within the prescribed guidelines.

Our Valuation Committee, comprised of all of our independent Board members, is responsible for reviewing and approving the valuation of our assets within the guidelines established by the Board of Directors.

Fair value is generally defined as the amount that an investment could be sold for in an orderly disposition over a reasonable time. Generally, to increase objectivity in valuing our assets, external measures of value, such as public markets or third-party transactions, are utilized whenever possible. Valuation is not based on long-term work-out value, nor immediate liquidation value, nor incremental value for potential changes that may take place in the future.

The values assigned to these investments 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 reasonably be determined until the individual investments are actually liquidated or become marketable.

Our valuation policy with respect to the five broad investment categories is as follows:

**Equity-Related Securities**

Equity-related securities are valued using one or more of the following basic methods of valuation:

**A. Cost.** The cost method is based on our original cost. This method is generally used in the early stages of a company's development until significant positive or negative events occur subsequent to the date of the original investment that dictate a change to another valuation method. Some examples of these events are: (1) a major recapitalization; (2) a major refinancing; (3) a significant third-party transaction; (4) the development of a meaningful public market for the company's common stock; and (5) significant positive or negative changes in a company's business.

**B. Analytical Method.** The analytical method is generally used to value an investment position when there is no established public or private market in the company's securities or when the factual information available to us dictates that an investment should no longer be valued under either the cost or private market method. This valuation method is inherently imprecise and ultimately the result of reconciling the judgments of our Valuation Committee members, based on the data available to them. The resulting valuation, although stated as a precise number, is necessarily within a range of values that vary depending upon the significance attributed to the various factors being considered. Some of the factors considered may include the financial condition and operating results of the company, the long-term potential of the business of the company, the values of similar securities issued by companies in similar businesses, 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.

**C. Private Market.** The private market method uses actual, executed, historical transactions in a company's securities by responsible third parties as a basis for valuation. The private market method may also use, where applicable, unconditional firm offers by responsible third parties as a basis for valuation.

**D. Public Market.** The public market method is used when there is an established public market for the class of the company's securities held by us or into which our securities are convertible. We discount market value for securities that are subject to significant legal and contractual restrictions. Other securities, for which market quotations are readily available, are carried at market value as of the time of valuation. Market value for securities traded on securities exchanges or on the Nasdaq Global Market is the last reported sales price on the day of valuation. For other securities traded in the over-the-counter market and listed securities for which no sale was reported on that day, market value is the mean of the closing bid price and asked price on that day. This method is the preferred method of valuation when there is an established public market for a company's securities, as that market provides the most objective basis for valuation.

### **Investments in Intellectual Property or Patents or Research and Development in Technology or Product Development**

These investments are carried at fair value using the following basic methods of valuation:

**E. Cost.** The cost method is based on our original cost. This method is generally used in the early stages of commercializing or developing intellectual property or patents or research and development in technology or product development until significant positive or adverse events occur subsequent to the date of the original investment that dictate a change to another valuation method.

**F. Analytical Method.** The analytical method is used to value an investment after analysis of the best available outside information where the factual information available to us dictates that an investment should no longer be valued under either the cost or private market method. This valuation method is inherently imprecise and ultimately the result of reconciling the judgments of our Valuation Committee members. The resulting valuation, although stated as a precise number, is necessarily within a range of values that vary depending upon the significance attributed to the various factors being considered. Some of the factors considered may include the results of research and development, product development progress, commercial prospects, term of patent and projected markets.

**G. Private Market.** The private market method uses actual third-party investments in intellectual property or patents or research and development in technology or product development as a basis for valuation, using actual executed historical transactions by responsible third parties. The private market method may also use, where applicable, unconditional firm offers by responsible third parties as a basis for valuation.

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As of March 31, 2007, we do not have any investments in intellectual property or patents or research and development in technologies or products.

### **Long-Term Fixed-Income Securities**

**H. Readily Marketable.** Fixed-income securities for which market quotations are readily available are carried at market value as of the time of valuation using the most recent bid quotations when available.

**I. Not Readily Marketable.** Securities for which market quotations are not readily available are carried at fair value using one or more of the following basic methods of valuation:

- Fixed-income securities are valued by independent pricing services that provide market quotations based primarily on quotations from dealers and brokers, market transactions, and other sources.
- Other fixed-income securities that are not readily marketable are valued at fair value by our Valuation Committee.

### **Short-Term Fixed-Income Investments**

**J.** Short-term fixed-income investments are valued at market value at the time of valuation. We value short-term debt with remaining maturity of 60 days or less at amortized cost.

### **All Other Investments**

**K.** All other investments are reported at fair value as determined in good faith by the Valuation Committee. As of March 31, 2007, we do not have any of these investments.

The reported values of securities for which market quotations are not readily available and for other assets reflect the Valuation Committee's judgment of fair values as of the valuation date using the outlined basic methods of valuation. They do not necessarily represent an amount of money that would be realized if we had to sell the securities in an immediate liquidation. Thus, valuations as of any particular date are not necessarily indicative of amounts that we may ultimately realize as a result of future sales or other dispositions of investments we hold.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 1. THE COMPANY**

Harris & Harris Group, Inc. (the "Company," "us," "our" and "we"), is a venture capital company operating as a business development company ("BDC") under the Investment Company Act of 1940 ("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 and Exchange Act of 1934 as an operating company and, while an operating company, operated directly and through subsidiaries.

Harris & Harris Enterprises, Inc.<sup>SM</sup> ("Enterprises"), is a 100 percent wholly owned subsidiary of the Company. Enterprises is a partner in Harris Partners I, L.P.<sup>SM</sup> and is taxed under Subchapter C of the Code (a "C Corporation"). Harris Partners I, L.P. is a limited partnership and owns our interest in AlphaSimplex Group, LLC. The partners of Harris Partners I, L.P., are Enterprises (sole general partner) and Harris & Harris Group, Inc. (sole limited partner).

We filed for the 1999 tax year to elect treatment as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986 (the "Code") and qualified for the same treatment for the years 2000 through 2005 pursuant to Section 851(e) of the Code. On March 29, 2007, we filed for RIC certification under Section 851(e) of the Code for 2006, although we qualified as a RIC for 2006 without such certification. However, there can be no assurance that we will qualify as a RIC for 2007 or subsequent years. In addition, under certain circumstances, even if we qualified for Subchapter M treatment for 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. As a RIC, we must, among other things, distribute at least 90 percent of our investment company taxable income and may either distribute or retain our realized net capital gains on investments.

**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 generally accepted accounting principles 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 generally accepted accounting principles in the United States of America. In the opinion of management, these financial statements reflect all adjustments, consisting only of 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, 2006.

**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 accounting principles generally accepted in the United States of America for investment companies and include the accounts of the Company and its wholly owned subsidiaries. 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 accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities as of March 31, 2007 and December 31, 2006, and the reported amounts of revenues and expenses for the three months ended March 31, 2007 and 2006. The most significant estimates relate to the fair valuations of certain of our investments. Actual results could differ from these estimates.

**Cash and Cash Equivalents.** Cash and cash equivalents include money market instruments with maturities of less than three months.

**Portfolio Investment Valuations.** 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.") At March 31, 2007, our financial statements include private venture capital investments valued at \$54,694,963, the fair values of which were determined in good faith by, or under the direction, of the Board of Directors. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. The difference could be material.

**Foreign Currency Translation.** The accounting records of the Company are maintained in U.S. dollars. All assets and liabilities denominated in foreign currencies are translated into U.S. dollars based on the rate of exchange of such currencies against U.S. dollars on the date of valuation. At March 31, 2007, included in the unrealized loss on investments was \$15,947 resulting from foreign currency translation.

**Securities Transactions.** Securities transactions are accounted for on the date the securities are purchased or sold (trade date); dividend income is recorded on the ex-dividend date; and interest income is accrued as earned. The Company ceases accruing interest when securities are determined to be non-income producing and writes off any previously accrued interest. Realized gains and losses on investment transactions are determined by specific identification for financial reporting and tax reporting.

**Stock-Based Compensation.** The Company has a stock-based employee compensation plan. The Company accounts for the plan in accordance with the provisions of SFAS No. 123(R), "Share-Based Payment." See Note 4 for further discussion.

Income Taxes. Prior to our conversion to a RIC in 1999, our taxes were accounted for in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109.

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

In June 2006, the FASB issued Interpretation 48, "*Accounting for Uncertainty in Income Taxes*" ("FIN 48"), an interpretation of FASB Statement No. 109, "*Accounting for Income Taxes.*" FIN 48 clarifies the accounting and reporting for income taxes where interpretation of the law is uncertain. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken in income tax returns. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted this Statement on January 1, 2007, which had no effect on the Company's financial statements. The Company recognizes interest and penalties in income tax expense. See Note 7 for further discussion.

Restricted Funds. The Company maintains 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.

Property and Equipment. Property and equipment are included in "Other Assets" and are carried at cost, less accumulated depreciation of \$289,880. Depreciation is provided using the straight-line method over the estimated useful lives of the premises and equipment.

Recent Accounting Pronouncements. In February 2007, the FASB issued Statement No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities*" ("SFAS 159"). SFAS 159 would allow the Company an irrevocable election to measure certain financial assets and liabilities at fair value, with unrealized gains and losses on the elected items recognized in earnings at each reporting period. The fair value option may only be elected at the time of initial recognition of a financial asset or financial liability or upon the occurrence of certain specified events. The election is applied on an instrument by instrument basis, with a few exceptions, and is applied only to entire instruments and not to portions of instruments. SFAS 159 also provides expanded disclosure requirements regarding the effects of electing the fair value option on the financial statements. SFAS 159 is effective prospectively for fiscal years beginning after November 15, 2007. The Company is currently evaluating this Statement. However, as investments are carried at fair value, the Company does not anticipate that this statement will have a significant impact on the consolidated financial statements.

#### **NOTE 4. STOCK-BASED COMPENSATION**

On March 23, 2006, the Board of Directors of the Company voted to terminate the Employee Profit-Sharing Plan and establish the Harris & Harris Group, Inc. 2006 Equity Incentive Plan (the "Stock Plan"), subject to shareholder approval. This proposal was approved at the May 4, 2006, Annual Meeting of Shareholders. The Stock Plan provides for the grant of equity-based awards of stock options and restricted stock (subject to receipt of an exemption order described below) to our directors, officers and employees who are selected by our Compensation Committee for participation in the plan and subject to compliance with the 1940 Act.



On July 11, 2006, the Company filed an application with the SEC regarding certain provisions of the Stock Plan. In the event that the SEC provides the exemptive relief requested by the application and we receive any additional stockholder approval required by the SEC, the Compensation Committee may, in the future, authorize awards under the Stock Plan to certain former officers of the Company, non-employee directors of the Company, authorize grants of restricted stock and adjust the exercise price of options to reflect taxes paid for deemed dividends.

A maximum of 20 percent of our total shares of our common stock issued and outstanding are available for awards under the Stock Plan. Under the Stock Plan, no more than 25 percent of the shares of stock reserved for the grant of the awards under the Stock Plan may be restricted stock awards at any time during the term of the Stock Plan. If any shares of restricted stock are awarded, such awards will reduce on a percentage basis the total number of shares of stock for which options may be awarded. If the Company does not receive exemptive relief from the SEC to issue restricted stock, all shares granted under the Stock Plan may be subject to stock options. No more than 1,000,000 shares of our common stock may be made subject to awards under the Stock Plan to any individual in any year.

On June 26, 2006, the Compensation Committee of the Board of Directors of the Company approved individual stock option awards for certain officers and employees of the Company. Both non-qualified stock options ("NQSOs") and incentive stock options ("ISOs"), subject to the limitations of Section 422 of the Internal Revenue Code, were awarded under the Stock Plan. The terms and conditions of the stock options granted were determined by the Compensation Committee and set forth in award agreements between the Company and each award recipient. A total of 3,958,283 stock options were granted with vesting periods ranging from December 2006 to June 2014 and with an exercise price of \$10.11. Upon exercise, the shares will be issued from our previously authorized shares. The full Board of Directors ratified and approved the grants on August 3, 2006, on which date the Company's common stock price fluctuated between \$9.76 and \$10.00.

The Company accounts for the Stock Plan in accordance with the provisions of SFAS No. 123(R), "Share-Based Payment," which requires that we determine 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 March 31, 2007, 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 intends to qualify as a RIC under Subchapter M of the Code.

The amount of 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 forfeitures that occur before vesting. 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.

For the three months ended March 31, 2007, the Company recognized \$1,690,181 of compensation expense in the Consolidated Statements of Operations. As of March 31, 2007, there was approximately \$8,393,087 of unrecognized compensation cost related to unvested stock option awards. This cost is expected to be recognized over a weighted-average period of approximately 1.86 years.

For the three months ended March 31, 2007, options to purchase a total of 326,012 shares were exercised for total proceeds to the Company of \$3,295,978.

For the three months ended March 31, 2007, the calculation of the net decrease in net assets resulting from operations per share excludes the stock options because such options were anti-dilutive. The 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.

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A summary of the changes in outstanding stock options 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, 2007	3,699,611	\$ 10.11	\$ 4.43		
Granted	-	-	-		
Exercised	326,012	\$ 10.11	\$ 1.74		\$ 916,094
Forfeited or Expired	-				
Options Outstanding at March 31, 2007	3,373,599	\$ 10.11	\$ 4.68	4.76	\$ 9,479,813
Options Exercisable at March 31, 2007	741,017	\$ 10.11	\$ 3.71	3.84	\$ 2,082,258
Options Exercisable and Expected to be Exercisable at March 31, 2007	3,007,610	\$ 10.11	\$ 4.63	4.71	\$ 8,451,384

The aggregate intrinsic value in the table above is calculated as the difference between the Company's closing stock price of \$12.92 on the last trading day of the first quarter of 2007 and the exercise price, multiplied by the number of in-the-money options. This represents the total pre-tax intrinsic value that would have been received by the option holders had all option holders fully vested and exercised their awards on March 31, 2007.

Unless earlier terminated by our Board of Directors, the Stock Plan will expire on May 4, 2016. The expiration of the Stock Plan will not by itself adversely affect the rights of plan participants under awards that are outstanding at the time the Stock Plan expires. Our Board of Directors may terminate, modify or suspend the plan at any time, provided that no modification of the plan will be effective unless and until any required shareholder approval has been obtained. The Compensation Committee may terminate, modify or amend any outstanding award under the Stock Plan at any time, provided that in such event, the award holder may exercise any vested options prior to such termination of the Stock Plan or award.

**NOTE 5. EMPLOYEE PROFIT-SHARING PLAN**

Prior to the adoption of the Stock Plan, the Company operated the Amended and Restated Harris & Harris Group, Inc. Employee Profit-Sharing Plan (the "2002 Plan"). Effective May 4, 2006, the 2002 Plan was terminated.

The 2002 Plan (and its predecessor) provided for profit sharing by our officers and employees equal to 20 percent of our "qualifying income" for that plan year.

As soon as practicable following the year-end, the Compensation Committee determined whether, and if so how much, qualifying income existed for a plan year. Approximately, 90 percent of the amount determined by the Compensation Committee was then paid out to Plan participants pursuant to the distribution percentages set forth in the 2002 Plan. The remaining payment was paid out after we finalized our tax returns for that plan year.

At March 31, 2007, and December 31, 2006, we accrued \$0 and \$261,661, respectively, for profit sharing. On March 1, 2006, the Company paid \$1,897,072 to plan participants (employees and former employees), which represented approximately 90 percent of the total estimated profit-sharing payment for 2005. The balance of \$261,661 was paid on January 31, 2007, upon finalization of our tax returns.

As discussed in Note 4, subject to receiving exemptive relief from the SEC, the Company may permit certain former officers of the Company to be participants of the Stock Plan. Alternatively, the SEC may provide relief which would permit us to pay out the remainder, if any, of the former officers' grandfathered participations under the terminated 2002 Plan.

**NOTE 6. DISTRIBUTABLE EARNINGS**

As of December 31, 2006, and March 31, 2007, there were no distributable earnings. The difference between the book basis and tax basis components of distributable earnings is primarily nondeductible deferred compensation and net operating losses.

**NOTE 7. INCOME TAXES**

Provided that a proper election is made, a corporation taxable under Subchapter C of the Code or a C Corporation that elects to qualify as a RIC continues to be taxable as a C Corporation on any gains realized within 10 years of its qualification as a RIC (the "Inclusion Period") from sales of assets that were held by the corporation on the effective date of the RIC election ("C Corporation Assets"), to the extent of any gain built into the assets on such date ("Built-In Gain"). If the corporation fails to make a proper election, it is taxable on its Built-In Gain as of the effective date of its RIC election. We had Built-In Gains at the time of our qualification as a RIC and made the election to be taxed on any Built-In Gain realized during the Inclusion Period.

We adopted FIN 48 as of January 1, 2007, the beginning of our fiscal year. As of January 1, 2007, we had unrecognized tax benefits of \$0 and did not record any cumulative effect adjustment to net assets as a result of adopting FIN 48.

For federal tax purposes, the Company's 2003 through 2006 tax years remain open for examination by the tax authorities under the normal three year statute of limitations. Generally, for state tax purposes, the Company's 2002 through 2006 tax years remain open for examination by the tax authorities under a four year statute of limitations.

During the first quarter of 2007, we paid \$9,455 in federal income taxes. At March 31, 2007, we had \$74,454 accrued for interest and penalties.

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 March 31, 2007, and 2006, our income tax expense (benefit) for Harris & Harris Enterprises, Inc., was \$0 and \$9,606, respectively.

Continued qualification as a RIC requires us to satisfy certain investment asset diversification requirements in future years. Our ability to satisfy those requirements may not be controllable by us. There can be no assurance that we will qualify as a RIC in subsequent years.

#### **NOTE 8. CAPITAL TRANSACTIONS**

On November 29, 2006, we filed a registration statement with the SEC on Form N-2 with respect to 4,000,000 shares of our common stock. On December 11, 2006, and on April 23, 2007, we filed amended registration statements with the SEC. After the effective date, the common stock may be sold at prices and on terms to be set forth in one or more supplements to the prospectus from time to time.

In September of 2005, we completed the sale of 3,507,500 shares for gross proceeds of \$37,091,813; net proceeds of the offering, after offering costs of \$565,246, were \$36,526,567. We intend to use, and have been using, the net proceeds of the offering to make new investments in tiny technology as well as follow-on investments in our existing venture capital investments, and for working capital.

#### **NOTE 9. SUBSEQUENT EVENTS**

On April 26, 2007, we made a \$233,918 follow-on investment in a privately held tiny technology portfolio company.

On April 30, 2007, we made a \$680,240 follow-on investment in a privately held tiny technology portfolio company.

On May 3, 2007, we made an \$800,000 new investment in a privately held tiny technology portfolio company.

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

	<b>Three Months Ended March 31</b>	
	<b>2007</b>	<b>2006</b>
<b>Per Share Operating Performance</b>		
Net asset value per share, beginning of period	\$ 5.42	\$ 5.68
Net operating loss*	(0.13)	(0.04)
Net realized income (loss) on investments*	0	0
Net increase in unrealized depreciation as a result of sales*	0	0
Net increase in unrealized depreciation on investments held*	(0.17)	(0.04)
Total from investment operations*	(.30)	(0.08)
Net increase as a result of stock-based compensation	0.08	0
Net increase as a result of proceeds from exercise of options	0.07	0
Total increase from capital stock transactions	0.15	0
Net asset value per share, end of period	\$ 5.27	\$ 5.60
Stock price per share, end of period	\$ 12.92	\$ 13.95
Total return based on stock price <sup>(1)</sup>	6.87%	0.36%
<b>Supplemental Data:</b>		
Net assets, end of period	\$ 112,526,302	\$ 116,333,752
Ratio of expenses to average net assets <sup>(1)</sup>	2.9%	1.3%
Ratio of net operating loss to average net assets <sup>(1)</sup>	(2.4)%	(0.7)%
Cash dividends paid per share	\$ 0	\$ 0
Deemed dividend per share	\$ 0	\$ 0

Number of shares outstanding, end of period	21,341,029	20,756,345
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\*Based on Average Shares Outstanding.

<sup>(1)</sup> Not Annualized

The accompanying notes are an integral part of this schedule.

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**4,000,000 Shares**

**Common Stock**

Harris & Harris Group, Inc.<sup>®</sup>, is a venture capital company specializing in tiny technology that operates as a business development company under the Investment Company Act of 1940. We may offer, from time to time, shares of our common stock, \$0.01 par value per share ("Common Stock"), in one or more delayed offerings. The Common Stock may be offered at prices and on terms to be set forth in one or more supplements to this Prospectus (each a "Prospectus Supplement"). The offering price per share of our Common Stock will not be less than the net asset value per share of our Common Stock at the time we make the offering exclusive of any underwriting commissions or discounts. You should read this Prospectus and the applicable Prospectus Supplement carefully before you invest in our Common Stock.

Our Common Stock may be offered directly to one or more purchasers through agents designated from time to time by us, or to or through underwriters or dealers. The Prospectus Supplement relating to the offering will identify any agents or underwriters involved in the sale of our Common Stock, and will set forth any applicable purchase price, fee, commission or discount arrangement between us and our agents or underwriters, or among our underwriters, or the basis upon which such amount may be calculated. We may not sell any of our Common Stock through agents, underwriters or dealers without delivery of a Prospectus Supplement describing the method and terms of the particular offering of our Common Stock. Our Common Stock is listed on the Nasdaq Global Market under the symbol "TINY." On April 19, 2007, the last reported sale price of our Common Stock was \$13.67.

**An Investment in the Securities Offered in this Prospectus Involves a High Degree of Risk. You Should Consider Investing in Us Only if You Are Capable of Sustaining the Loss of Your Entire Investment. See "Risk Factors" beginning on page 11.**

This Prospectus sets forth concisely the information about us that a prospective investor should know before investing. You should read this Prospectus, before deciding whether to invest in our Common Stock, and retain it for future reference. You may obtain our annual reports, request other information about us and make shareholder inquiries by calling toll free 1-877-TINY TECH. Additional information about us has been filed with the Securities and Exchange Commission ("SEC") and is available upon written or oral request and without charge. We also make available our annual reports, free of charge, on our website at [www.TinyTechVC.com](http://www.TinyTechVC.com). Information on our website is not part of this Prospectus and should not be considered as such when making your investment decision. Material incorporated by reference and other information about us can be obtained from the SEC's website (<http://www.sec.gov>).

Neither the SEC nor any state securities commission has approved or disapproved these securities or determined if this Prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of the Prospectus is May 11, 2007.



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**You should rely only on the information contained or incorporated by reference in this Prospectus. We have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction in which the offer or sale is not permitted.**

In this Prospectus, unless otherwise indicated, "Harris & Harris," "Company," "us," "our" and "we" refer to Harris & Harris Group, Inc.® "Harris & Harris Group, Inc." is a registered service mark. This Prospectus also includes trademarks owned by other persons.

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## PROSPECTUS SUMMARY

*This summary highlights information that is described more fully elsewhere in this Prospectus and in the documents to which we have referred. It may not contain all of the information that is important to you. To understand the offering fully, you should read the entire document carefully, including the risk factors beginning on page 11.*

### **Our Business**

Harris & Harris Group, Inc., is a venture capital company, specializing in tiny technology, that operates as a business development company under the Investment Company Act of 1940, which we refer to as the 1940 Act. For tax purposes, we operate as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986, which we refer to as the Code. We are an internally managed investment company; that is, our officers and employees, rather than an investment adviser, manage our operations under the general supervision of our Board of Directors. Our investment objective is to achieve long-term capital appreciation, rather than current income, by making venture capital investments in early-stage companies. Our approach includes patient examination of available early stage opportunities, thorough due diligence and close involvement with management.

We make initial venture capital investments exclusively in "tiny technology," which we define as nanotechnology, microsystems and microelectromechanical systems (which we refer to as MEMS). We consider a company to be a tiny technology company if a product or products, or intellectual property covering a product or products, that we consider to be at the microscale or smaller is material to its business plan. Most of our current portfolio companies are significantly involved with work on objects or devices with dimensions of 100 nanometers or smaller, which we refer to as the nanoscale. Our portfolio includes insignificant non-tiny technology investments made prior to 2001, and we may make follow-on investments in either tiny or non-tiny technology companies. At December 31, 2006, 45.4 percent of our total assets and 99.9 percent of our venture capital portfolio were invested in tiny technology investments. Accordingly, we do not expect a material portion of our venture capital portfolio will include non-tiny technology companies. By making these investments, we seek to provide our shareholders with a specific focus on tiny technology through a portfolio of venture capital investments that addresses a variety of markets and products. We believe that we are the only publicly traded business development company making initial venture capital investments exclusively in tiny technology.

Tiny technology is multidisciplinary and widely applicable, and it incorporates technology that is significantly smaller than is currently in widespread commercial use in most fields. Nanotechnology is 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. Because it is in many respects a new field, tiny technology has significant scientific, engineering, regulation and commercialization risks. See "Business" and "Risk Factors."

As a venture capital company, we make it possible for our investors to participate at an early stage in this emerging field, while our portfolio companies are still private. By making investments in companies that control intellectual property relevant to tiny technology, we are building a portfolio that we believe will be difficult to replicate in the future, as we believe it will likely become increasingly difficult to create new foundational intellectual property in nanotechnology. Because we typically invest as part of a syndicate of venture capital firms, the syndicate's time horizon often determines ours, though we may provide seed capital before forming a syndicate with other investors, or maintain our investment in an investee company after it goes public, even after our co-investors sell or distribute their shares. To the investor, we offer:

- a portfolio consisting of investments that are generally available only to a small, highly specialized group of professional venture capital firms as investors;

a team of professionals, including five full-time members of management, four of whom are designated as Managing Directors, Charles E. Harris, Douglas W. Jamison, Daniel V. Leff and Alexei A. Andreev, and a Vice President, Daniel B. Wolfe, to evaluate and monitor investments. Two of our directors are also consultants to us, Kelly S. Kirkpatrick and Lori D. Pressman. These seven professionals collectively have expertise in venture capital investing, intellectual property and tiny technology;

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- the opportunity to benefit from our experience in a new field expected to permeate a variety of industries; and
- through the ownership of our publicly traded shares, a measure of liquidity not typically available in underlying venture capital portfolio investments.

The number of tiny technology investment opportunities available to us has increased over the past five years, through both new opportunities and opportunities for follow-on investments in our existing portfolio companies. We believe that our expertise and record of prior investments in tiny technology are likely to lead us to additional tiny technology investment opportunities in the future. We intend to use the net proceeds of this offering to:

- increase our capital in order to take advantage of these investment opportunities;
- lower our expenses as a percentage of assets and otherwise achieve certain economies and advantages of scale in our operations, as our costs are primarily fixed. As our assets increase by the net proceeds of this offering, our fixed costs will represent a smaller percentage of our assets; and
- pay operating expenses, including due diligence expenses on potential investments.

We identify investment opportunities primarily through four channels:

- our involvement in the field of tiny technology;
- research universities that seek to transfer their scientific discoveries to the private sector;
- other venture capital companies seeking co-investors or referring deals to us; and
- direct calls and business plan submissions by companies, business incubators and individuals seeking venture capital.

Since registering as an investment company in 1992, we have invested in a variety of industries. In 1994, we invested in our first tiny technology company, Nanophase Technologies Corporation. In 1995, we elected to be regulated as a business development company. Recognizing the potential of tiny technology, we continued to monitor developments in the field, and since 2001, we have made tiny technology our exclusive focus for initial investments. From August 2001 through December 2006, all 31 of our initial investments have been in companies involved in the development of products and technologies based on tiny technology. At December 31, 2006, our portfolio includes investments in a total of 29 companies, 27 of which we consider to be involved in tiny technology.

As is usual in the venture capital industry, our venture capital investments are generally in convertible preferred stock, which is usually the most senior security in a portfolio company's equity capital structure until the company has substantial revenues, and which gives us seniority over the holders of common stock (usually including the founders) while preserving fully our participation in the upside potential of the portfolio company through the conversion feature. Our portfolio investments in some instances include a dividend right payable in kind (which increases our participation in the portfolio company) or potentially in cash. In-kind distributions are primarily made in additional shares of convertible preferred stock. We expect to continue to invest in convertible securities.

## **Tiny Technology**

In our view, tiny technology is neither an industry nor a single technology, but a variety of enabling technologies with critical dimensions below 100 micrometers. Tiny technology manifests itself in tools, materials, systems and devices that address broad markets, including instrumentation, electronics, photonics, computing, medical devices, pharmaceutical manufacturing, drug delivery and drug discovery. The development and commercialization of tiny technology often require the integration of multiple disciplines, including biology, physics, chemistry, materials science, computer science and the engineering sciences.

Examples of tiny technology-enabled products currently on the market are quite diverse. They include sensors, accelerometers used in automobiles to sense impact and deploy airbags, cosmetics with ingredients that block ultraviolet light but are invisible to the human eye, nanoclays used for strength in the running boards of minivans, textiles with liquid-stain repellent surfaces, fast acting painkillers and certain pharmaceutical therapeutics.

Harris & Harris Group currently has 13 companies in its tiny technology portfolio with products on the market offering a range of products including components for optical networking, high-brightness LEDs, carbon nanotube-based sensors, optical switches, silicon carbide brake rotors, chiral columns for the pharmaceutical industry, metabolomic profiling services and decorative tiles.

Within tiny technology, microsystems and MEMS both refer to materials, devices and processes that are on a micrometer size scale. A micrometer, which is also referred to as a micron, is 0.000001 meter, or one millionth of a meter. In practice, any device, or device enabled by components, in a size range from 100 microns down to 0.1 micron may be considered "micro." Nanotechnology refers to materials, devices and processes with critical dimensions below 0.1 micron, equal to 100 nanometers. A nanometer is 0.00000001 meter, or one billionth of a meter. It is at the scale below 100 nanometers, the nanoscale, that quantum effects begin to dominate classical macroscale physics. At the nanoscale, size- and shape-dependent properties of materials allow previously unattainable material and device performance.

Although the practical application of tiny technology requires great expertise to implement in manufacturing processes, we believe that tiny technology's broad applicability presents significant and diverse market opportunities.

## **Risk Factors**

Set forth below is a summary of certain risks that you should carefully consider before investing in our Common Stock. See "Risk Factors" beginning on page 11 for a more detailed discussion of the risks of investing in our Common Stock.

### **Risks related to the companies in our portfolio.**

- A continuing lack of initial public offering opportunities may cause companies to stay in our portfolio longer, leading to lower returns, write-downs and write-offs.
  - Investing in small, private companies involves a high degree of risk and is highly speculative.
- We may invest in companies working with technologies or intellectual property that currently have few or no proven commercial applications.
  - Our portfolio companies may not successfully develop, manufacture or market their products.
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Our portfolio companies working with tiny technology may be particularly susceptible to intellectual property litigation.

- Unfavorable general economic conditions, as well as unfavorable conditions specific to the venture capital industry, could result in the inability of our portfolio companies to access additional capital, leading to financial losses in our portfolio.

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- The value of our portfolio could be adversely affected if the technologies utilized by our portfolio companies are found or even rumored or feared, to cause health or environmental risks, or if legislation is passed that limits the commercialization of any of these technologies.
- Public perception(s) of ethical and social issues, including health and environment risks regarding nanotechnology, may limit or discourage the use of nanotechnology-enabled products, which could reduce our portfolio companies' revenues and harm our business.
  - Our portfolio companies may generate revenues from the sale of non-tiny technology-enabled products.

**Risks related to the illiquidity of our investments.**

- We invest in illiquid securities and may not be able to dispose of them when it is advantageous to do so, or ever.
- Unfavorable economic conditions and regulatory changes could impair our ability to engage in liquidity events.
- Even if some of our portfolio companies complete initial public offerings, the returns on our investments in those companies would be uncertain.

**Risks related to our Company.**

- Because there is generally no established market in which to value our investments, our Valuation Committee's value determinations may differ materially from the values that a ready market or third party would attribute to these investments.
- Changes in valuations of our privately held, early stage companies tend to be more volatile than changes in prices of public traded securities.
  - We expect to continue to experience material write-downs of securities of portfolio companies.
- Because we are a non-diversified company with a relatively concentrated portfolio, the value of our business is subject to greater volatility than the value of companies with more broadly diversified investments.
  - We are dependent upon key management personnel for future success and may not be able to retain them.
    - We will need to hire additional employees as the size of our portfolio increases.
  - The market for venture capital investments, including tiny technology investments, is highly competitive.
- In addition to the difficulty of finding attractive investment opportunities, our status as a regulated business development company may hinder our ability to participate in investment opportunities or to protect the value of existing investments.
- Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio.
- Bank borrowing or the issuance of debt securities or preferred stock by us, to fund investments in portfolio companies or to fund our operating expenses, would make our total return to common shareholders more volatile. The use of debt would leverage our available common equity capital, magnifying the impact of changes in the value of our investment portfolio on our net asset value. In addition, the cost of debt or preferred stock financing could exceed the return on the assets the proceeds are used to acquire, in which case the use of leverage would have an

adverse impact on the holders of our Common Stock.

- We are authorized to issue preferred stock, which would convey special rights and privileges to its owners senior to those of Common Stock shareholders.

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- Loss of status as a RIC would reduce our net asset value and distributable income.
- We operate in a heavily regulated environment, and changes to, or non-compliance with, regulations and laws could harm our business.
  - Market prices of our Common Stock will continue to be volatile.
  - Quarterly results fluctuate and are not indicative of future quarterly performance.
- To the extent that we do not realize income or choose not to retain after-tax realized capital gains, we will have a greater need for additional capital to fund our investments and operating expenses.
  - Investment in foreign securities could result in additional risks.

**Risks related to this offering.**

- Investing in our stock is highly speculative and an investor could lose some or all of the amount invested.
  - We will have discretion over the use of proceeds of this offering.
- Our shares might trade at discounts from net asset value or at premiums that are unsustainable over the long term.
  - You have no right to require us to repurchase your shares.

**Other Information**

Our website is [www.TinyTechVC.com](http://www.TinyTechVC.com) and is not incorporated by reference into this Prospectus. We make available free of charge through our website the following materials (which are not incorporated by reference unless specifically stated in this Prospectus) as soon as reasonably practicable after filing or furnishing them to the SEC:

- our annual report on Form 10-K;
- our quarterly reports on Form 10-Q;
- our current reports on Form 8-K; and
  - amendments to those reports.

**The Offering**

**Common Stock offered**  
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We may offer, from time to time, up to a total of 4,000,000 shares of our Common Stock available under this Prospectus on terms to be determined at the time of the offering. Our Common Stock may be offered at prices and on terms to be set forth in one or more Prospectus Supplements. The offering price per share of our Common Stock net of underwriting commissions or discounts will not be less than the net asset value per share of our Common Stock.

**Use of proceeds**  
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Although we will make initial investments exclusively in tiny technology, we can make follow-on investments in non-tiny technology companies currently in our portfolio. Further, while considering venture capital investments, we may invest the proceeds in U.S. government and agency securities, which may yield less than our operating expense ratio. We expect to invest or reserve for potential follow-on investment the net proceeds of any sale of shares under this Prospectus within two years from the completion of such sale. We may also use the proceeds of this offering for operating expenses, including due diligence expenses on potential investments. Our portfolio companies rarely pay us dividends or interest, and we do not generate enough income from fixed income investments to meet all of our operating expenses. For this purpose, we do not expect to reserve for follow-on investments in any particular portfolio holding more than the greater of twice the investment to date in that portfolio holding or five times the initial investment in the case of seed-stage investments, though we may invest more than the amount reserved for this purpose in any particular portfolio holding.

**Dividends and Distributions**  
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To the extent that we retain any net capital gain, we may make deemed capital gain dividends. If we do make a deemed capital gain dividend, you will not receive a cash distribution, but instead you will receive a tax credit and increase in basis equal to your proportionate share of the tax paid by us on your behalf. We currently intend to retain our net capital gains for investment and pay the associated federal corporate income tax. We may change this policy in the future. See "Taxation."

**Nasdaq Global Market  
symbol**  
.....

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**TABLE OF FEES AND EXPENSES**

The following tables are intended to assist you in understanding the various costs and expenses directly or indirectly associated with investing in our Common Stock. Amounts are for the current fiscal year after giving effect to anticipated net proceeds of the offering for the 4,000,000 shares registered pursuant to this Prospectus, assuming that we incur the estimated offering expenses. The price per share used in this calculation was the closing price of our Common Stock on April 19, 2007 of \$13.67.

## Shareholder Transaction Expenses

Sales Load <sup>(1)</sup> (as a percentage of offering price)	N/A
Offering Expenses (as a percentage of offering price)	0.60%
Annual Expenses (as a percentage of net assets attributable to Common Stock)	
Management Fees <sup>(2)</sup>	N/A
Other Expenses <sup>(3)</sup>	
Salaries and Benefits <sup>(4)</sup>	4.74%
Administration and Operations <sup>(5)</sup>	1.14%
Professional Fees	.44%
Total Annual Expenses <sup>(6)</sup>	6.32%

**Example**

The following examples illustrate the dollar amount of cumulative expenses that would be incurred over various periods with respect to a hypothetical investment in our Common Stock. These amounts are based upon payment by us of expenses at levels set forth in the above table, including the non-cash, stock-based compensation expenses.

On the basis of the foregoing, including the non-cash, stock-based compensation expense, you would pay the following expenses on a \$10,000 investment, assuming a five percent annual return:\*

<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>
\$684	\$1,908	\$3,099	\$5,943

\*This example includes non-cash, stock-based compensation. Excluding the non-cash, stock-based compensation, you would pay expenses of \$394 in 1 year, \$1,078 in 3 years, \$1,785 in 5 years and \$3,659 in 10 years, on a \$10,000 investment, assuming a five percent return.

The foregoing table is to assist you in understanding the various costs and expenses that an investor in our Common Stock will bear directly or indirectly. The assumed five percent annual return is not a prediction of, and does not represent, the projected or actual performance of our Common Stock. **The above example should not be considered a representation of future expenses, and actual expenses and annual rates of return may be more or less than those assumed for purposes of the example.**

(1) In the event that the shares of Common Stock to which this Prospectus relates are sold to or through underwriters, a corresponding Prospectus Supplement will disclose the sales load.

(2) The Company has no external management fees because it is internally managed.

(3) "Other Expenses" are based on amounts for the fiscal year ended December 31, 2006.

(4) "Salaries and Benefits" includes non-cash stock-based compensation expense of \$5,038,956. The Company accounts for stock-based compensation expense pursuant to SFAS No. 123(R) "Share-Based Payment," which requires that we determine 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. There is no effect on net asset value from stock-based compensation expense at the time of grant. If options are exercised, net asset value per share will be decreased if the net asset value per share at the time of exercise is higher than the exercise price and net asset value per share will be increased if the net asset value per share at the time of exercise is lower than the exercise price. Excluding the non-cash, stock-based compensation expense, "Salaries and benefits" totals \$2,945,195 or 1.78 percent of net assets attributable to Common Stock.

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(5) "Administration and Operations" includes expenses incurred for administration, operations, rent, directors' fees and expenses, depreciation and custodian fees.

(6) "Total Annual Expenses" includes non-cash compensation expense of \$5,038,956. See Footnote (4) above. Cash-based total annual expenses as a percentage of net assets attributable to Common Stock is 3.39%.

### SELECTED CONDENSED CONSOLIDATED FINANCIAL DATA

The information below should be read in conjunction with the Consolidated Financial Statements and Supplementary Data and the notes thereto. Financial information as of and for the years ended December 31, 2006, 2005, 2004, 2003 and 2002, has been derived from our financial statements that were audited by PricewaterhouseCoopers LLP. These historical results are not necessarily indicative of the results to be expected in the future.

#### BALANCE SHEET DATA

##### Financial Position as of December 31:

	2006	2005	2004	2003	2002
Total assets	\$ 118,328,590	\$ 132,938,120	\$ 79,361,451	\$ 44,115,128	\$ 35,951,969
Total liabilities	\$ 4,398,287	\$ 14,950,378	\$ 4,616,652	\$ 3,432,390	\$ 8,695,923
Net assets	\$ 113,930,303	\$ 117,987,742	\$ 74,744,799	\$ 40,682,738	\$ 27,256,046
Net asset value per outstanding share	\$ 5.42	\$ 5.68	\$ 4.33	\$ 2.95	\$ 2.37
Cash dividends paid	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Cash dividends paid per outstanding share	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Shares outstanding, end of year	21,015,017	20,756,345	17,248,845	13,798,845	11,498,845



**Operating Data for year ended December 31:**

	2006	2005	2004	2003	2002
Total investment income	\$ 3,028,761	\$ 1,540,862	\$ 637,562	\$ 167,785	\$ 253,461
Total expenses <sup>1</sup>	\$ 10,641,696	\$ 7,006,623	\$ 4,046,341	\$ 2,731,527	\$ 2,124,549
Net operating (loss) income	\$ (7,612,935)	\$ (5,465,761)	\$ (3,408,779)	\$ (2,563,742)	\$ (1,871,088)
Total tax (benefit) expense <sup>2</sup>	\$ (227,355)	\$ 8,288,778	\$ 650,617	\$ 13,761	\$ 199,309
Net realized income (loss) from investments	\$ 258,693	\$ 14,208,789	\$ 858,503	\$ (984,925)	\$ 2,390,302
Net (increase) decrease in unrealized depreciation on investments	\$ (4,418,870)	\$ (2,026,652)	\$ 484,162	\$ 343,397	\$ (3,241,408)
Net (decrease) increase in net assets resulting from operations	\$ (11,773,112)	\$ 6,716,376	\$ (2,066,114)	\$ (3,205,270)	\$ (2,722,194)
(Decrease) Increase in net assets resulting from operations per average outstanding share	\$ (0.57)	\$ 0.36	\$ (0.13)	\$ (0.28)	\$ (0.27)

<sup>1</sup>Included in total expenses are the following profit-sharing expenses/(reversals): \$50,875 in 2006; \$1,796,264 in 2005; \$311,594 in 2004; and (\$163,049) in 2002. Also included in total expenses is non-cash, stock-based compensation expense of \$5,038,956 in 2006. There was no stock-based compensation expense in 2005, 2004, 2003 or 2002.

<sup>2</sup>Included in total tax expense are the following taxes paid by the Company on behalf of shareholders: \$0 in 2006, \$8,122,367 in 2005, \$0 in each of 2004, 2003 and 2002.

**SELECTED QUARTERLY DATA (UNAUDITED)**

	2006			
	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	4 <sup>th</sup> Quarter
Total investment income	\$ 804,862	\$ 785,265	\$ 719,619	\$ 719,015
Net operating loss	\$ (767,743)	\$ (693,887)	\$ (2,988,790)	\$ (3,162,515)
Net increase (decrease) in net assets resulting from operations	\$ (1,653,990)	\$ (1,282,997)	\$ (2,588,092)	\$ (6,248,033)
Net (decrease) increase in net assets resulting from operations	\$ (0.08)	\$ (0.06)	\$ (0.12)	\$ (0.31)

## 2005

	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	4 <sup>th</sup> Quarter
Total investment income	\$ 260,108	\$ 158,717	\$ 315,374	\$ 801,662
Net operating loss	\$ (745,590)	\$ (3,302,094)	\$ (3,273,797)	\$ 1,851,274
Net increase (decrease) in net assets resulting from operations	\$ (2,233,447)	\$ 7,001,847	\$ 7,336,923	\$ (5,388,947)
Net (decrease) increase in net assets resulting from operations				
Per average outstanding share	\$ (0.13)	\$ 0.41	\$ 0.40	\$ (0.26)

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**SELECTED QUARTERLY DATA (UNAUDITED)**  
(continued)

	<b>2004</b>			
	<b>1<sup>st</sup> Quarter</b>	<b>2<sup>nd</sup> Quarter</b>	<b>3<sup>rd</sup> Quarter</b>	<b>4<sup>th</sup> Quarter</b>
Total investment income	\$ 56,536	\$ 79,231	\$	