

HARRIS & HARRIS GROUP INC /NY/  
Form 10-K  
March 16, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

**Form 10-K**

**x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2014

or

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

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

Commission File No. 0-11576

**HARRIS & HARRIS GROUP, INC.®**  
(Exact Name of Registrant as Specified in Its Charter)

New York 13-3119827  
(State or Other Jurisdiction (I.R.S. Employer  
of Incorporation or Organization) Identification No.)

1450 Broadway, 24th Floor, New York, New York 10018  
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code (212) 582-0900

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$.01 par value	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:

None  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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

Yes  No

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

Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  No

The aggregate market value of the common stock held by non-affiliates of Registrant as of June 30, 2014 was \$96,778,889 based on the last sale price as quoted by the Nasdaq Global Market on such date (only officers and directors are considered affiliates for this calculation).

As of March 13, 2015, the registrant had 31,280,843 shares of common stock, par value \$.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE INCORPORATED AT

Harris & Harris Group, Inc. Proxy Statement for the 2015 Annual Meeting of Shareholders	Part III, Items 10, 11, 12, 13 and 14
---	---------------------------------------

**TABLE OF CONTENTS**

	Page
<b>PART I</b>	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	16
Item 1B. <u>Unresolved Staff Comments</u>	37
Item 2. <u>Properties</u>	38
Item 3. <u>Legal Proceedings</u>	38
Item 4. <u>Mine Safety Disclosures</u>	38
<b>PART II</b>	
Item 5. <u>Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	39
Item 6. <u>Selected Financial Data</u>	42
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	43
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	95
Item 8. <u>Consolidated Financial Statements and Supplementary Data</u>	98
Item 9. <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	171
Item 9A. <u>Controls and Procedures</u>	171
Item 9B. <u>Other Information</u>	171
<b>PART III</b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	172
Item 11. <u>Executive Compensation</u>	172
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	172
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	172
Item 14. <u>Principal Accountant Fees and Services</u>	173
<b>PART IV</b>	
Item 15. <u>Exhibits and Financial Statements Schedules</u>	174
<u>Signatures</u>	177
<u>Exhibit Index</u>	178

## **PART I**

### **Item 1. Business.**

Harris & Harris Group, Inc.<sup>®</sup> (the "Company," "us," "our," and "we"), is an internally managed venture capital company that builds transformative companies from disruptive science. We have elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940, (the "1940 Act"). For tax purposes, we have elected to be treated as a regulated investment company ("RIC") under Subchapter M of the Internal Revenue Code of 1986 (the "Code"). We were incorporated under the laws of the state of New York in August 1981. Our investment objective is to achieve long-term capital appreciation by making venture capital investments. Generation of current income is a secondary objective. We define venture capital investments as the money and resources made available to privately held and publicly traded small businesses that we believe have exceptional growth potential. Our investment approach is comprised of a patient examination of available opportunities thorough due diligence and close involvement with management of our portfolio companies. As a venture capital company, we invest in and offer managerial assistance to our portfolio companies, many of which, in our opinion, have significant potential for growth. We are overseen by our Board of Directors and managed by our officers and have no external investment advisor.

Our investment focus over the coming years will have two characteristics: 1) it will be early stage, where our focus will be on founding, incubating and building transformative companies from disruptive science and 2) it will be focused on BIOLOGY+. We define our investment focus of BIOLOGY+ as investments in interdisciplinary life science companies where biology innovation is intersecting with innovations in areas such as electronics, physics, materials science, chemistry, information technology, engineering and mathematics. We focus on this intersection because we believe interdisciplinary innovation will be required in order to address many of the life science challenges of the future. As of December 31, 2014, 58 percent of the value of our venture capital portfolio is invested in BIOLOGY+ companies. Since 2008, more than 80 percent of our initial investments have been in BIOLOGY+ companies.

We have demonstrated that we have the ability to discover, diligence, invest, build and realize gains in transformative companies built from disruptive science. We spend a tremendous amount of time with these companies, often playing managerial roles in the earliest stages of their development. Our technical knowledge is important at this stage. Our success in building management teams and focusing on key market opportunities is critical at this stage. As these companies develop, we continue to invest in them, and we invite other investors with complementary skill-sets to invest and add value. In many of these companies, there is a round of capital that has an asymmetrical or outsized return potential compared to other rounds. By being in the companies early, and by recognizing this opportunity, we believe we have the potential to deliver outsized returns even though the investment time period may be long. We also believe we have an investment thesis and an interdisciplinary team that are difficult to replicate and give us a competitive advantage.



As of December 31, 2014, our venture capital portfolio comprised 80.1 percent of our total assets, our cash comprised 18.5 percent of our total assets, and other assets comprised the remaining 1.4 percent of our total assets. As of December 31, 2014, we had no debt outstanding.

Neither our investments, nor an investment in us, is intended to constitute a balanced investment program. We expect to be risk seeking rather than risk averse in our investment approach. To such end, we reserve the fullest possible freedom of action, subject to our certificate of incorporation, applicable law and regulations, and policy statements contained herein. There is no assurance that our investment objectives will be achieved.

We expect to invest a substantial portion of our assets in securities that we consider to be private venture capital equity investments. These private venture capital equity investments usually do not pay interest or dividends and typically are subject to legal or contractual restrictions on resale that may adversely affect the liquidity and marketability of such securities. Some of our convertible bridge notes may result in payment-in-kind ("PIK") interest. We do not limit our investments to any categories of investments. Our securities investments may consist of private, public or governmental issuers of any type, subject to the restrictions imposed on us as a BDC under the 1940 Act. Subject to the diversification requirements applicable to a RIC, we may commit all of our assets to only a few investments.

We currently invest our capital directly into portfolio companies. We may in the future seek to invest our capital alongside capital from other investors through investment funds that we control. Such funds could provide benefits to us including 1) the generation of income from management fees; 2) the potential to participate economically in the returns on the funds invested above and beyond the returns generated from investment of our capital; 3) the ability for us to increase the amount of capital under our control invested per portfolio company and 4) in cases where we may partner with one or more corporations, we gain access to market intelligence and distribution and manufacturing expertise that complements our expertise in identifying disruptive innovations and building companies.

Achievement of our investment objective is dependent upon the judgment of a team of four professional, full-time members of management, all of whom are designated as Managing Directors: Douglas W. Jamison, Daniel B. Wolfe, Alexei A. Andreev and Misti Ushio. This team collectively has expertise in venture capital investing, intellectual property and science and technology. There can be no assurance that a suitable replacement could be found for any of our officers upon their retirement, resignation, inability to act on our behalf, or death.

Subject to continuing to meet the compliance tests applicable to BDCs under the 1940 Act, there are no limitations on the types of securities or other assets in which we may invest. Investments may include the following:

- Venture capital investments, whether in corporate, partnership or other form, including small businesses;

Equity, equity-related securities (including warrants and options) and debt with equity features from either private or public issuers;

2



· Debt obligations of all types having varying terms with respect to security or credit support, subordination, purchase price, interest payments and maturity;

· Foreign securities;

· Intellectual property or patents or research and development in technology or product development that may lead to patents or other marketable technology; and

· Miscellaneous investments.

### Investments and Strategies

The following is a summary description of the types of assets in which we may invest, the investment strategies we may use and the attendant risks associated with our investments and strategies.

#### Venture Capital Investments

We define venture capital as the money and resources made available to privately held and publicly traded small businesses that we believe have exceptional growth potential. These businesses can range in stage from pre-revenue to generating positive cash flow. Substantially all of our long-term venture capital investments are in thinly capitalized, unproven, small companies focused on commercializing risky technologies. These businesses also tend to lack management depth, to have limited or no history of operations and to have not attained profitability. Because of the speculative nature of these investments, these securities have a significantly greater risk of loss than traditional investment securities. Some of our venture capital investments will never realize their potential, and some will be unprofitable or result in complete loss of our investment. Some of our venture capital investments will build successful companies but will not provide a return to us.

We may own 100 percent of the securities of a small business for a period of time and may control the company for a substantial period. Small businesses are more vulnerable to adverse business or economic developments than better-capitalized companies. Small businesses generally have limited product lines, markets and/or financial resources. Publicly traded small businesses and those with small market capitalizations are not well known to the investing public and are generally subject to high volatility, to general movements in markets, to perceptions of potential growth and/or the potential for bankruptcy.

In connection with our venture capital investments, we may participate in providing a variety of services to our portfolio companies, including the following:

- recruiting management;
- formulating operating strategies;
- formulating intellectual property strategies;

- assisting in financial planning;
- providing management in the initial start-up stages;
- introducing corporate and development partners; and
- establishing corporate goals.

We may assist in raising additional capital for these companies from other potential investors and may subordinate our own investment to that of other investors. We typically find it necessary or appropriate to provide additional capital of our own in rounds of financing subsequent to our initial investment. We may introduce these companies to potential joint venture partners, suppliers and customers. In addition, we may assist in establishing relationships with investment bankers and other professionals. We may also assist management of our investee companies with strategy and execution of merger and acquisition ("M&A") transactions. While we do not currently derive income from these companies for the performance of any of the above services, we may seek to do so in the future.

We may control, be represented on, or have observer rights on the board of directors of a portfolio company through one or more of our officers or directors, who may also serve as officers of the portfolio company. We indemnify our officers and directors for serving on the boards of directors or as officers of portfolio companies, which exposes us to additional risks. Particularly during the early stages of an investment, we may, in rare instances, in effect be conducting the operations of the portfolio company. As an early-stage company emerges from the developmental stage with greater management depth and experience, we expect that our role in the portfolio company's day-to-day operations will diminish. Our goal is to assist each company in establishing its own independent capitalization, management and board of directors. We expect to be able to reduce our involvement in those small businesses that become successful, as well as in those small businesses that fail.

#### Equity, Equity-Related Securities and Debt with Equity Features

We may invest in equity, equity-related securities and debt with equity features. These securities include common stock or units, preferred stock or units, debt instruments convertible into common or preferred stock or units, limited partnership interests, other beneficial ownership interests and warrants, options or other rights to acquire or agreements to sell any of the foregoing.

We primarily make investments in companies with operating histories that are unprofitable or marginally profitable, that have negative net worth, or that are involved in bankruptcy or reorganization proceedings. These investments would involve businesses that management believes have potential for rapid growth through the infusion of additional capital and management assistance. In addition, we may make investments in connection with the acquisition or

divestiture of companies or divisions of companies. There is a significantly greater risk of loss with these types of securities than is the case with traditional investment securities.

Warrants, options and convertible or exchangeable securities generally give the investor the right to acquire specified equity securities of an issuer at a specified price during a specified period or on a specified date. Warrants and options fluctuate in value in relation to the value of the underlying security and the remaining life of the warrant or option, while convertible or exchangeable securities fluctuate in value both in relation to the intrinsic value of the security without the conversion or exchange feature and in relation to the value of the conversion or exchange feature, which is like a warrant or option. When we invest in these securities, we incur the risk that the option feature will expire worthless, thereby either eliminating or diminishing the value of our investment.

Most of our current portfolio company investments are in the equity securities of private companies. Investments in equity securities of private companies often involve securities that are restricted as to sale and cannot be sold in the open market without registration under the Securities Act of 1933 or pursuant to a specific exemption from these registrations. Opportunities for sale are more limited than in the case of marketable securities, although these private investments may be purchased at more advantageous prices and may offer attractive investment opportunities. Even if one of our portfolio companies completes an initial public offering ("IPO"), we are typically subject to a lock-up agreement for 180 days or longer, and the stock price may decline substantially before we are free to sell or enter into contracts to sell these shares. These lock-up restrictions apply to us and our shares of the portfolio company owned prior to the IPO and may include shares purchased by us in an IPO. These restrictions generally include provisions that stipulate that we are not permitted to offer, pledge or sell our shares, including selling covered call options on our shares, prior to the expiration of the lock-up period. We are also prohibited from entering into new securities lending arrangements for these securities during the lock-up period. We may also own securities of privately held companies that complete public listings through reverse mergers into publicly traded shell companies. Our shares of the privately held company prior to the reverse merger may be subject to additional restrictions on their sale under Rule 144.

We may employ an option strategy of writing (selling) covered call options or purchasing put options on one or more of our public portfolio companies once any restrictions and/or lock-up periods expire. Call options are contracts representing the right to purchase a common stock at a specified price (the "strike price") at a specified future date (the "expiration date"). Selling a covered call option represents an obligation to sell a specified number of shares of common stock at a strike price by an expiration date if the stock achieves the strike price and if it is called. A call option whose strike price is above the current price of the underlying stock is called "out-of-the-money." A call option whose strike price is below the current price of the underlying stock is called "in-the-money." When stocks in the portfolio rise, call options that were out-of-the-money when written may become in-the-money, thereby increasing the likelihood that they could be exercised, and we would be forced to sell the stock. While this may be desirable in some instances, we may minimize undesirable option assignments by repurchasing the call options prior to expiration, generating a gain or loss in the options. If the options were not to be repurchased, the option holder could exercise its rights and buy the stock from us at the strike price if the stock traded at a higher price than the strike price. We will only "sell" or "write" options on common stocks held in our portfolio. We will not sell "naked" call options, *i.e.*, options representing more shares of the stock than are held in the portfolio. For conventional listed call options, the options' expiration dates are commonly up to nine months from the date the call options are first listed for trading. Longer-term call options can have expiration dates up to three years from the date of listing. We currently expect the majority of written call options to have expirations of equal to or less than one year from the date the call option is first listed for trading.

We may also purchase put options as a method of limiting the downside risk that the price per share of these companies may decrease substantially from current levels. A put option gives its holder the right to sell a specified number of shares of a specific security at a specific price (known as the exercise strike price) by a certain date. The buyer of a put option is betting that the price of the security will decrease before the option expires. The risk for us as the option holder is that the option expires unexercised, and we would have lost the money spent on buying the option.

We may utilize instruments such as forward contracts, currency options and interest rate swaps, caps, collars and floors to seek to hedge against fluctuations in the relative values of our portfolio positions from changes in market conditions, currency exchange rates and market interest rates. Hedging against a decline in the values of our portfolio positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline. However, such hedging can establish other positions designed to gain from those same developments, thereby offsetting the decline in the value of such portfolio positions.

We may also invest in publicly traded securities of whatever nature, including relatively small, emerging growth companies that management believes have long-term growth potential. These investments may be through open-market transactions or through private placements in publicly traded companies ("PIPEs"). Securities purchased in PIPE transactions are typically subject to a lock-up agreement for 180 days or longer, or are issued as unregistered securities that are not freely tradable for at least six months.

Even if we have registration rights to make our investments in privately held and publicly traded companies more marketable, a considerable amount of time may elapse between a decision to sell or register the securities for sale and the time when we are able to sell the securities. The prices obtainable upon sale may be adversely affected by market conditions, by the level of average trading volume of the underlying stock as compared with the position offered for sale or negative conditions affecting the issuer during the intervening time. We may elect to hold formerly restricted securities after they have become freely marketable, either because they remain relatively illiquid or because we believe that they may appreciate in value. During this holding period, the value of these securities may decline and be especially volatile. If we need funds for investment or working capital purposes, we might need to sell marketable securities at disadvantageous times or prices.

## **Debt Investments**

We may hold debt securities, including in privately held and thinly traded public companies, for income and as a reserve pending more speculative investments. Debt obligations may include U.S. government and agency securities, commercial paper, bankers' acceptances, receivables or other asset-based financing, notes, bonds, debentures, or other debt obligations of any nature and repurchase agreements related to these securities. These obligations may have varying terms with respect to security or credit support, subordination, purchase price, interest payment and length of time to maturity from private, public or governmental issuers of any type located anywhere in the world. We may invest in debt obligations of companies with operating histories that are unprofitable or marginally profitable, that

have negative net worth or are involved in bankruptcy or reorganization proceedings, or that are start-up or development-stage small businesses. In addition, we may participate in the acquisition or divestiture of companies or divisions of companies through issuance or receipt of debt obligations. As of December 31, 2014, the debt obligations held in our portfolio consisted of convertible bridge notes, senior secured debt and subordinated secured debt. The convertible bridge notes generally do not generate cash payments to us, nor are they held for that purpose. Our convertible bridge notes and the interest accrued thereon are generally held for the purpose of potential conversion into equity at a future date.

Our investments in debt obligations may be of varying quality, including non-rated, unsecured and highly speculative debt investments with limited marketability. Investments in lower-rated and non-rated securities, commonly referred to as "junk bonds," including our non-convertible debt investments, are subject to special risks, including a greater risk of loss of principal and non-payment of interest. Generally, lower-rated and non-rated securities offer a higher return potential than higher-rated securities, but involve greater volatility of price and greater risk of loss of income and principal, including the possibility of default or bankruptcy of the issuers of these securities. Lower-rated securities and comparable non-rated securities will likely have large uncertainties or major risk exposure to adverse economic conditions and are predominantly speculative with respect to the issuer's capacity to pay interest and repay principal in accordance with the terms of the obligation. In addition, issuers of lower-rated securities and comparable non-rated securities are often highly leveraged and may not have more traditional methods of financing available to them; therefore, their ability to service their debt obligations during an economic downturn or during sustained periods of rising interest rates may be impaired. The risk of loss owing to default by these issuers is significantly greater because lower-rated securities and comparable non-rated securities generally are unsecured and frequently are subordinated to the prior payment of senior indebtedness. We may incur additional expenses to the extent that we are required to seek recovery upon a default in the payment of principal or interest on our portfolio holdings. In addition, many of the companies in which we invest have limited cash flows and no income, which may limit our ability to recover in the event of a default.

The markets in which lower-rated securities or comparable non-rated securities are traded generally are more limited than those in which higher-rated securities are traded. The existence of limited markets for these securities may restrict our ability to obtain accurate market quotations for the purposes of valuing lower-rated or non-rated securities and calculating net asset value or to sell securities at their fair value. The market values of lower-rated and non-rated securities also tend to be more sensitive to individual corporate developments and changes in economic conditions than higher-rated securities. The occurrence of adverse conditions and uncertainties to issuers of lower-rated securities would likely reduce the value of lower-rated or non-rated securities held by us, with a commensurate effect on the value of our shares, when applicable.

The market values of investments in debt securities that carry no equity conversion rights usually reflect yields generally available on securities of similar quality and type at the time purchased. When interest rates decline, the market value of a debt portfolio already invested at higher yields can be expected to rise if the securities are protected against early call. Similarly, when interest rates increase, the market value of a debt portfolio already invested at lower yields can be expected to decline. Deterioration in credit quality also generally causes a decline in market value of the security, while an improvement in credit quality generally leads to increased value.



## Foreign Securities

We may make investments in securities of issuers whose principal operations are conducted outside the United States, and whose earnings and securities are stated in foreign currency. In order to comply with restrictions owing to our status as a BDC, our investments in non-qualifying assets, including the securities of companies organized outside the United States, would be limited to 30 percent of our assets, because under the 1940 Act, we must generally invest at least 70 percent of our assets in "qualifying assets," which exclude securities of foreign companies.

In comparison with otherwise comparable investments in securities of U.S. issuers, currency exchange risk of securities of foreign issuers is a significant variable. The value of these investments to us will vary with the relation of the currency in which they are denominated to the U.S. dollar, as well as with intrinsic elements of value such as credit risk, interest rates and performance of the issuer. Investments in foreign securities also involve risks relating to economic and political developments, including nationalization, expropriation of assets, currency exchange freezes and local recession. Securities of many foreign issuers are less liquid and more volatile than those of comparable U.S. issuers. Interest and dividend income and capital gains on our foreign securities may be subject to withholding and other taxes that may not be recoverable by us. We may seek to hedge all or part of the currency risk of our investments in foreign securities through the use of futures, options and forward currency purchases or sales.

## Intellectual Property

We believe there is a role for organizations that can assist in technology transfer. Scientists and institutions that develop and patent intellectual property perceive the need for and rewards of entrepreneurial commercialization of their inventions.

Our form of investment may be:

- funding research and development in the development of a technology;
- obtaining licensing rights to intellectual property or patents;
- acquiring intellectual property or patents; or
- forming and funding companies or joint ventures to commercialize further intellectual property.

Income from our investments in intellectual property or its development may take the form of participation in licensing or royalty income, fee income, or some other form of remuneration. In order to satisfy RIC requirements, these investments will normally be held in an entity taxable as a corporation. Investment in developmental intellectual property rights involves a high degree of risk that can result in the loss of our entire investment as well as additional risks, including uncertainties as to the valuation of an investment and potential difficulty in liquidating an investment. Further, investments in intellectual property generally require investor patience, as investment return may be realized only after or over a long period. At some point during the commercialization of a technology, our investment may be transformed into ownership of securities of a small business, as discussed under "Venture Capital Investments" above.

### **Borrowing and Margin Transactions**

We may from time to time borrow money or obtain credit by any lawful means from banks, lending institutions, other entities or individuals, in negotiated transactions. We may issue, publicly or privately, bonds, debentures or notes, in series or otherwise, with interest rates and other terms and provisions, including conversion rights, on a secured or unsecured basis, for any purpose, up to the maximum amounts and percentages permitted for BDCs under the 1940 Act. The 1940 Act currently prohibits us from borrowing any money or issuing any other senior securities (including preferred stock but excluding temporary borrowings of up to five percent of our assets), if after giving effect to the borrowing or issuance, the value of our total assets less liabilities not constituting senior securities would be less than 200 percent of our senior securities. We may pledge assets to secure any borrowings. As of December 31, 2014, we had no debt.

On September 30, 2013, the Company entered into a \$20,000,000 Multi-Draw Term Loan Facility Credit Agreement, by and among the Company, as borrower, Orix Corporate Capital, Inc., as administrative agent and the other lenders party thereto from time to time, which provides for a multi-draw credit facility (the "Loan Facility") that may be used by the Company to fund investments in portfolio companies. We have pledged our assets to secure any borrowings. As of December 31, 2014, we had no borrowings outstanding.

A primary purpose of our borrowing power is for leverage and to increase our ability to acquire larger positions in our investments while maintaining a substantial balance of cash on our balance sheet. As discussed in more detail below in "Management's Discussion and Analysis of Financial Condition and Results of Operations," we believe we need a strong balance sheet to have access to the best deal flow and take opportunities to gain or protect ownership in what we believe are our best companies. Borrowings for leverage accentuate any increase or decrease in the market value of our investments and thus our net asset value. Because any decline in the net asset value of our investments will be borne first by holders of common stock, the effect of leverage in a declining market would be a greater decrease in net asset value applicable to the common stock than if we were not leveraged. Any decrease would likely be reflected in a decline in the market price of our common stock. To the extent the income derived from assets acquired with borrowed funds exceeds the interest and other expenses associated with borrowing, our total income will be greater than if borrowings were not used. Conversely, if the income from assets is not sufficient to cover the borrowing costs, our total income will be less than if borrowings were not used. If our current income is not sufficient to meet our borrowing costs (repayment of principal and interest), we might have to liquidate some or all of our investments when it may be disadvantageous to do so. Our borrowings for the purpose of buying most liquid equity securities will be subject to the margin rules, which require excess liquid collateral marked to market daily. If we are unable to post sufficient collateral, we will be required to sell securities to remain in compliance with the margin rules. These sales might be at disadvantageous times or prices.

### **Portfolio Company Turnover**

Changes with respect to portfolio companies will be made as our management considers necessary in seeking to achieve our investment objectives. The rate of portfolio turnover will not be treated as a limiting or relevant factor considered by management when making portfolio changes.

Although we expect that many of our investments will be relatively long term in nature, we may make changes in our particular portfolio holdings whenever it is considered that an investment no longer has substantial growth potential or has reached its anticipated level of performance, or (especially when cash is not otherwise available) that another investment appears to have a relatively greater opportunity for capital appreciation. We may also make general portfolio changes to increase our cash to position us in a defensive posture. We may make portfolio changes without regard to the length of time we have held an investment, or whether a sale results in profit or loss, or whether a purchase results in the reacquisition of an investment that we may have only recently sold. Our investments in privately held small businesses are illiquid, which limits portfolio turnover. The portfolio turnover rate may vary greatly during a year as well as from year to year and may also be affected by cash requirements.

### **Competition**

Numerous companies and individuals are engaged in the venture capital business, and such business is intensely competitive. We believe our corporate structure permits public market investors to participate in venture capital and to participate in the commercialization of science-related breakthroughs while many of the leading companies are still private. We also believe our corporate structure permits greater liquidity and better transparency than other venture capital businesses. We believe that we have invested in more science-enabled small businesses than any United States-based publicly traded venture capital firm. We believe we have assembled a team of investment professionals that, in addition to a proven track record of successful venture capital investing, have scientific and intellectual property expertise that is relevant to investing in science-related breakthroughs. Nevertheless, many of our competitors have significantly greater financial and other resources than we do and are, therefore, in certain respects, in a better position than we are to obtain access to attractive venture capital investments. There can be no assurance that we will be able to compete against these venture capital businesses for attractive investments, particularly in capital-intensive companies.

### **Regulation**

The Small Business Investment Incentive Act of 1980 added the provisions of the 1940 Act applicable only to BDCs. BDCs are a special type of investment company. After a company files its election to be treated as a BDC, it may not withdraw its election without first obtaining the approval of holders of a majority of its outstanding voting

securities. The following is a brief description of the 1940 Act provisions applicable to BDCs, qualified in its entirety by reference to the full text of the 1940 Act and the rules issued thereunder by the Securities and Exchange Commission ("SEC").

Generally, to be eligible to elect BDC status, a company must primarily engage in the business of furnishing capital and making significant managerial assistance available to companies that do not have ready access to capital through conventional financial channels such as private companies and small public companies. Such companies that satisfy certain additional criteria described below are termed "eligible portfolio companies." In general, in order to qualify as a BDC, a company must: (i) be a domestic company; (ii) have registered a class of its securities pursuant to Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act"); (iii) operate for the purpose of investing in the securities of certain types of portfolio companies, including early-stage or emerging companies and businesses suffering or just recovering from financial distress (see following paragraph); (iv) make available significant managerial assistance to such portfolio companies; and (v) file a proper notice of election with the SEC.

An eligible portfolio company generally is a domestic company that is not an investment company or a company excluded from investment company status pursuant to exclusions for certain types of financial companies (such as brokerage firms, banks, insurance companies and investment banking firms) and that: (i) has a fully diluted market capitalization of less than \$250 million and has a class of equity securities listed on a national securities exchange, (ii) does not have a class of securities listed on a national securities exchange, or (iii) is controlled by the BDC by itself or together with others (control under the 1940 Act is presumed to exist where a person owns at least 25 percent of the outstanding voting securities of the portfolio company) and has a representative on the Board of Directors of such company.

As with other companies regulated by the 1940 Act, a BDC must adhere to certain substantive regulatory requirements. A majority of the directors must be persons who are not interested persons, as that term is defined in the 1940 Act. Additionally, we are required to provide and maintain a bond issued by a reputable fidelity insurance company to protect the BDC. Furthermore, as a BDC, we are prohibited from protecting any director or officer against any liability to us or our shareholders arising from willful malfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of such person's office. We may be periodically examined by the SEC for compliance with the 1940 Act and Federal securities laws.

The 1940 Act provides that we may not make an investment in non-qualifying assets unless at the time at least 70 percent of the value of our total assets (measured as of the date of our most recently filed financial statements) consists of qualifying assets. Qualifying assets include: (i) securities of eligible portfolio companies; (ii) securities of certain companies that were eligible portfolio companies at the time we initially acquired their securities and in which we retain a substantial interest; (iii) securities of certain controlled companies; (iv) securities of certain bankrupt, insolvent or distressed companies; (v) securities received in exchange for or distributed in or with respect to any of the foregoing; and (vi) cash items, U.S. government and agency securities and high quality short-term debt. The SEC has adopted a rule permitting a BDC to invest its cash in certain money market funds. The 1940 Act also places restrictions on the nature of the transactions in which securities can be purchased in some instances in order for the securities to be considered qualifying assets.

We are permitted by the 1940 Act, under specified conditions, to issue multiple classes of debt and a single class of preferred stock if our asset coverage, as defined in the 1940 Act, is at least 200 percent after the issuance of the debt or the preferred stock (i.e., such senior securities may not be in excess of our net assets). Under specific conditions, we are also permitted by the 1940 Act to issue warrants.

Except under certain conditions, we may sell our securities at a price that is below the prevailing net asset value per share only during the 12-month period after (i) a majority of our directors and our disinterested directors have determined that such sale would be in the best interest of us and our shareholders and (ii) the holders of a majority of our outstanding voting securities and the holders of a majority of our voting securities held by persons who are not affiliated persons of ours approve our ability to make such issuances. A majority of the disinterested directors must determine in good faith that the price of the securities being sold is not less than a price which closely approximates the market value of the securities, less any distribution discount or commission.

Certain transactions involving certain closely related persons of the Company, including its directors, officers and employees, may require the prior approval of the SEC. However, the 1940 Act ordinarily does not restrict transactions between us and our portfolio companies.

We have adopted a code of ethics pursuant to Rule 17j-1 under the 1940 Act that establishes procedures for personal investments and restricts certain personal securities transactions. Personnel subject to the code may invest in securities for their personal investment accounts, including securities that may be purchased or held by us, so long as such investments are made in accordance with the code's requirements.

### **Tax Status**

We have elected to be treated as a RIC, taxable under Subchapter M of the Code, for federal income tax purposes. In general, a RIC is not taxable on its income or gains to the extent it distributes such income or gains to its shareholders. In order to qualify for favorable RIC tax treatment, we must, in general, (1) annually derive at least 90 percent of our gross income from dividends, interest and gains from the sale of securities and similar sources (the "Income Source Rule"); (2) quarterly meet certain investment asset diversification requirements (the "Asset Diversification Rule"); and (3) annually distribute at least 90 percent of our investment company taxable income as a dividend (the "Income Distribution Rule"). Any taxable investment company income not distributed will be subject to corporate level tax. Any taxable investment company income distributed generally will be taxable to shareholders as dividend income.

In addition to the requirement that we must annually distribute at least 90 percent of our investment company taxable income, we may either distribute or retain our realized net capital gains from investments, but any net capital gains not distributed may be subject to corporate level tax. Any net capital gains distributed generally will be taxable to

shareholders as long-term capital gains.



In lieu of actually distributing our realized net capital gains, we as a RIC may retain all or part of our net capital gains and elect to be deemed to have made a distribution of the retained portion to our shareholders under the "designated undistributed capital gain" rules of the Code. We currently intend to retain and so designate all of our net capital gains. In this case, the "deemed dividend" generally is taxable to our shareholders as long-term capital gains. Although we pay tax at the corporate rate on the amount deemed to have been distributed, our shareholders receive a tax credit equal to their proportionate share of the tax paid and an increase in the tax basis of their shares by the amount per share retained by us.

To the extent that we declare a deemed dividend, each shareholder will receive an IRS Form 2439 that will reflect each shareholder's receipt of the deemed dividend income and a tax credit equal to each shareholder's proportionate share of the tax paid by us. This tax credit, which is paid at the corporate rate, is often credited at a higher rate than the actual tax due by a shareholder on the deemed dividend income. The "residual" credit can be used by the shareholder to offset other taxes due in that year or to generate a tax refund to the shareholder. Tax exempt investors may file for a refund.

The following simplified examples illustrate the tax treatment under Subchapter M of the Code for us and our individual shareholders with regard to three possible distribution alternatives, assuming a net capital gain of \$1.00 per share, consisting entirely of sales of non-real property assets held for more than 12 months.

**Under Alternative A:** 100 percent of net capital gain declared as a cash dividend and distributed to shareholders:

I. No federal taxation at the Company level.

J. Taxable shareholders receive a \$1.00 per share dividend and pay federal tax at a rate not in excess of 15 percent\* or \$.15 per share, retaining \$.85 per share.

K. Non-taxable shareholders that file a federal tax return receive a \$1.00 per share dividend and pay no federal tax, retaining \$1.00 per share.

**Under Alternative B (Current Tax Structure Employed):** 100 percent of net capital gain retained by the Company and designated as "undistributed capital gain" or deemed dividend:

I. The Company pays a corporate-level federal income tax of 35 percent on the undistributed gain or \$.35 per share and retains 65 percent of the gain or \$.65 per share.

J. Taxable shareholders increase their cost basis in their stock by \$.65 per share. They pay federal capital gains tax at a rate not in excess of 15 percent\* on 100 percent of the undistributed gain of \$1.00 per share or \$.15 per share in tax. Offsetting this tax, shareholders receive a tax credit equal to 35 percent of the undistributed gain or \$.35 per share.

K. Non-taxable shareholders that file a federal tax return receive a tax refund equal to \$.35 per share.

\*Assumes all capital gains qualify for long-term rates of 15 percent, which may increase for gains realized after December 31, 2014.

**Under Alternative C:** 100 percent of net capital gain retained by the Company, with no designated undistributed capital gain or deemed dividend:

I. The Company pays a corporate-level federal income tax of 35 percent on the retained gain or \$.35 per share plus an excise tax of four percent of \$.98 per share, or about \$.04 per share.

J. There is no tax consequence at the shareholder level.

Although we may retain income and gains subject to the limitations described above (including paying corporate level tax on such amounts), we could be subject to an additional four percent excise tax if we fail to distribute 98 percent of our "regulated investment company ordinary income" and 98.2 percent of our "capital gain net income" for the relevant determination period.

As noted above, in order to qualify as a RIC, we must satisfy the Asset Diversification Rule each quarter. Because of the specialized nature of our investment portfolio, in some years we have been able to satisfy the diversification requirements under Subchapter M of the Code primarily as a result of receiving certification from the SEC under the Code with respect to each taxable year beginning after 1998 that we were "principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available" for such year.

Although we received SEC certifications for 1999-2013, there can be no assurance that we will receive such certification for subsequent years (to the extent we need additional certifications as a result of changes in our portfolio). We intend to apply for certification for 2014. If we require, but fail to obtain, the SEC certification for a taxable year, we may fail to qualify as a RIC for such year. We also will fail to qualify for favorable RIC tax treatment for a taxable year if we do not satisfy the Income Source Rule or Income Distribution Rule for such year. In the event we do not satisfy the Income Source Rule, the Asset Diversification Rule and the Income Distribution Rule for any taxable year, we will be subject to federal tax with respect to all of our taxable income, whether or not distributed. In addition, all our distributions to shareholders in that situation generally will be taxable as ordinary dividends.

Although we currently intend to qualify as a RIC for each taxable year, under certain circumstances we may choose to take action with respect to one or more taxable years to ensure that we would be taxed under Subchapter C of the Code (rather than Subchapter M) for such year or years. Additionally, our ownership percentages in our portfolio have grown over the last several years, which make it more difficult to pass certain RIC diversification tests when companies in our portfolio are successful and we want to invest more capital in those companies to increase our investment returns. As long as the aggregate values of our non-qualifying assets remain below 50 percent of total assets, we will continue to qualify as a RIC. Rather than selling portfolio companies that are performing well in order to pass our RIC diversification tests, we may opt instead not to qualify as a RIC. We will choose to take such action only if we believe that the result of the action will benefit us and our shareholders.

### **Subsidiaries**

H&H Ventures Management, Inc.<sup>SM</sup> ("Ventures"), formerly Harris & Harris Enterprises, Inc.<sup>SM</sup>, is a 100 percent wholly owned subsidiary of the Company and is consolidated in our financial statements. Ventures is a partner in Harris Partners I, L.P.<sup>SM</sup>, and is taxed as a C Corporation. Harris Partners I, L.P., is a limited partnership and has historically owned our interests in partnership investments. The partners of Harris Partners I, L.P., are Ventures (sole general partner) and the Company (sole limited partner). Ventures, as the sole general partner, consolidates Harris Partners I, L.P.

### **Available Information**

Additional information about us, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are available as soon as reasonably practicable free of charge on our website at [www.HHVC.com](http://www.HHVC.com). Information contained on our website is not incorporated by reference into this Annual Report on Form 10-K, and you should not consider that information to be part of this Annual Report on Form 10-K.

You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information regarding the Public Reference Room by calling the SEC at 1-800-SEC-0330.

### **Employees**

As of December 31, 2014, we employed 12 full-time employees and one part-time employee. As of March 1, 2015, we have 10 full-time employees and one part-time employee. We believe our relations with our employees are generally good.

## Item 1A. Risk Factors.

Investing in our common stock involves significant risks relating to our business and investment objectives. You should carefully consider the risks and uncertainties described below before you purchase any shares of our common stock. These risks and uncertainties are not the only ones we face. Unknown additional risks and uncertainties, or ones that we currently consider immaterial, may also impair our business. If any of these risks or uncertainties materialize, our business, financial condition or results of operations could be materially adversely affected. In this event, the trading price of our common stock could decline, and you could lose all or part of your investment.

Risks related to our investments.

**Approximately 49.1 percent of the net asset value attributable to our equity-focused venture capital investment portfolio, or 38.5 percent of our net asset value, as of December 31, 2014, is concentrated in Adesto Technologies Corporation, Metabolon, Inc., Enumeral Biomedical Holdings, Inc., and D-Wave Systems, Inc.**

At December 31, 2014, we valued our investment in Adesto, which had a historical cost to us of \$10,482,417, at \$14,823,323, our investment in Metabolon, which had a historical cost to us of \$7,224,999, at \$10,696,559, our investment in Enumeral, which had a historical cost to us of \$5,591,299, at \$8,384,641, and our investment in D-Wave, which had a historical cost to us of \$5,787,955, at \$8,335,524, which collectively represent 49.1 percent of the net asset value attributable to our equity-focused venture capital investment portfolio, excluding our rights to potential future milestone payments from the sale of BioVex to Amgen, or 38.5 percent of our net asset value.

Any downturn in the business outlook and/or substantial changes in the funding requirements of Adesto, Metabolon, Enumeral or D-Wave could have a significant effect on the value of our current investments in those companies, and the overall value of our portfolio, and could have a significant adverse effect on the value of our common stock.

**The difficult venture capital investment and capital market climates for the types of companies in which we invest could increase the non-performance risk for our portfolio companies.**

While the public markets and corporate growth are improving, unemployment remains relatively high on a historical basis, and the potential for future global instabilities and inflation remain of concern. Even with signs of economic improvement, the availability of capital for venture capital firms that focus on investments in capital-intensive, science-enabled, small businesses, such as the ones in which we invest, continues to be limited. Historically, difficult venture environments have resulted in a higher than normal number of small businesses not receiving financing and

being subsequently closed down with a loss to venture investors, and other small businesses receiving financing but at significantly lower valuations than the preceding financing rounds. This issue is compounded by the fact that a number of our investments include participation from venture capital funds that have few remaining years of investment and available capital owing to the finite lifetime of these funds. Additionally, even if a firm were able to raise a new fund, commonly new venture capital funds are not permitted to invest with old funds in existing investments. As such, improvements in the liquidity environment for venture-backed companies through IPOs and M&A transactions and the currently improving public markets in general may not translate to an increase in the available capital to the types of venture-backed companies we invest in. Further, many of our portfolio companies receive non-dilutive funding through government contracts and grants. Reductions in government spending could have a direct and significant reduction in our portfolio companies' contract or grant awards. Such reductions can also result in reduced budgets at research facilities, which would reduce the volume of products they could potentially purchase from our portfolio companies.

We believe that these factors continue to contribute to the potential for non-performance risk for our portfolio companies that need to raise additional capital or that require substantial amounts of capital to execute on their business plans, as measured on an individual portfolio company basis. We define non-performance as the risk that the price per share (or implied valuation of a portfolio company) or the effective yield of a debt security of a portfolio company, as applicable, does not appropriately represent the risk that a portfolio company that requires or seeks to raise additional capital will be: (a) unable to raise capital, will need to be shut down and will not return our invested capital; or (b) able to raise capital, but at a valuation significantly lower than the implied post-money valuation of the most recent round of financing. In these circumstances, the portfolio company could be recapitalized at a valuation significantly lower than the post-money valuation implied by our valuation method, sold at a loss to our investment or shut down. In addition, significant changes in the capital markets, including periods of extreme volatility and disruption, have had, and may in the future have, a negative effect on the valuations of our investments and on the potential for liquidity events involving our investments. We believe further that the long-term effects of the difficult venture capital investment and difficult, but improving, liquidity environments will continue to affect negatively the fundraising ability of some small businesses regardless of near-term improvements in the overall global economy and public markets.

**Changes in valuations of early-stage small businesses tend to be more volatile than changes in prices of established, more mature securities.**

Investments in early- and mid-stage small businesses may be inherently more volatile than investments in more mature businesses. Such immature businesses are inherently fragile and easily affected by both internal and external forces. Our investee companies can lose much or all of their value suddenly in response to an internal or external adverse event. Conversely, these immature small businesses can gain suddenly in value in response to an internal or external positive development. Moreover, because of the lack of daily pricing mechanisms of our privately held companies, our ownership interests in such investments are generally valued only at quarterly intervals by our Valuation Committee. Thus, changes in valuations from one valuation point to another may be larger than changes in valuations of marketable securities that are revalued in the marketplace much more frequently, in some highly liquid cases, virtually continuously. Although we carefully monitor each of our portfolio companies, information pertinent to our portfolio companies is not always known immediately by us, and, therefore, its availability for use in determining value may not always coincide with the timeframe of our valuations required by the Federal securities laws.



As of December 31, 2014, our shares of Champions Oncology, Inc., and a portion of our shares of Enumeral Biomedical Holdings, Inc., which trade on an OTC exchange, were valued using the closing price at the end of the quarter as required by the 1940 Act owing to our determination that the common stock of these companies traded in an active market as of the valuation date. If in future quarters, shares of Champions Oncology and Enumeral Biomedical do not continue to trade in an active market as of the dates of valuation, the value of our shares could be materially different.

Additionally, we may price or invest in rounds at lower valuations than prior rounds of financing and/or previously reported valuations in order to receive more favorable terms, such as increased ownership percentages or liquidation preferences, which may result in decreased valuations in the interim. These decreases could be material.

**The capital markets may experience periods of disruption and instability. Such market conditions may materially and adversely affect debt and equity capital markets in the United States, which may have a negative impact on our business and operations.**

From time to time, capital markets may experience periods of disruption and instability. For example, between 2008 and 2009, the global capital markets were unstable as evidenced by periodic disruptions in liquidity in the debt capital markets, significant write-offs in the financial services sector, the re-pricing of credit risk in the broadly syndicated credit market and the failure of major financial institutions. Despite actions of the U.S. federal government and foreign governments, these events contributed to declining general economic conditions that materially and adversely impacted the broader financial and credit markets and reduced the availability of debt and equity capital for the market as a whole and financial services firms in particular. While market conditions have experienced relative stability in recent years, there have been continuing periods of volatility, and there can be no assurance that adverse market conditions will not reoccur in the future.

Equity capital may be difficult to raise during periods of adverse or volatile market conditions because, subject to some limited exceptions, as a BDC, we are generally not able to issue additional shares of our common stock at a price below our net asset value without first obtaining approval for such issuance from our stockholders and our independent directors.

Significant changes or volatility in the capital markets may also have a negative effect on the valuations of our investments. While most of our investments are not publicly traded, applicable accounting standards require us to assume as part of our valuation process that our investments are sold in a principal market to market participants. Significant changes in the capital markets may also affect the pace of our investment activity and the potential for liquidity events involving our investments. Thus, the illiquidity of our investments may make it difficult for us to sell such investments, and, as a result, we could realize significantly less than the amount at which we have valued our investments if we were required to sell them for liquidity purposes. An inability to raise or access capital could have a material adverse effect on our business, financial condition or results of operations.



**Uncertainty about the financial stability of the United States and of several countries in the European Union (EU) could have a significant adverse effect on our business, financial condition and results of operations.**

Owing to federal budget deficit concerns, S&P downgraded the federal government's credit rating from AAA to AA+ for the first time in history on August 5, 2011. Further, Moody's and Fitch had warned that they may downgrade the federal government's credit rating. Further downgrades or warnings by S&P or other rating agencies, and the U.S. government's credit and deficit concerns in general, could cause interest rates and borrowing costs to rise, which may negatively impact both the perception of credit risk associated with our debt portfolio and our ability to access the debt markets on favorable terms. In addition, a decreased U.S. government credit rating could create broader financial turmoil and uncertainty, which may weigh heavily on our financial performance and the value of our common stock.

In 2010, a financial crisis emerged in Europe, triggered by high budget deficits and rising direct and contingent sovereign debt in Greece, Ireland, Italy, Portugal and Spain, which created concerns about the ability of these nations to continue to service their sovereign debt obligations. While the financial stability of such countries has improved significantly, risks resulting from any future debt crisis in Europe or any similar crisis could have a detrimental impact on the global economic recovery, sovereign and non-sovereign debt in these countries and the financial condition of European financial institutions. Market and economic disruptions have affected, and may in the future affect, consumer confidence levels and spending, personal bankruptcy rates, levels of incurrence and default on consumer debt and home prices, among other factors. We cannot assure you that market disruptions in Europe, including the increased cost of funding for certain governments and financial institutions, will not impact the global economy, and we cannot assure you that assistance packages will be available or, if available, be sufficient to stabilize countries and markets in Europe or elsewhere affected by a financial crisis. To the extent uncertainty regarding any economic recovery in Europe negatively impacts consumer confidence and consumer credit factors, our business, financial condition and results of operations could be significantly and adversely affected.

In October 2014, the Federal Reserve announced that it was concluding its bond-buying program, or quantitative easing, which was designed to stimulate the economy and expand the Federal Reserve's holdings of long-term securities, suggesting that key economic indicators, such as the unemployment rate, had showed signs of improvement since the inception of the program. It is unclear what effect, if any, the conclusion of the Federal Reserve's bond-buying program will have on the value of our investments. However, it is possible that, without quantitative easing by the Federal Reserve, these developments, along with the U.S. government's credit and deficit concerns and the European sovereign debt crisis, could cause interest rates and borrowing costs to rise, which may negatively impact our portfolio company's ability to access the debt markets on favorable terms.

Investing in small, privately held and publicly traded companies involves a high degree of risk and is highly speculative.

We have invested a substantial portion of our assets in privately held companies, the securities of which are inherently illiquid. We may seek to invest in publicly traded small businesses that we believe have exceptional growth potential. Our privately held companies may transition to publicly traded companies through routes other than traditional IPOs and be listed on OTC rather than national exchanges. Although these companies are publicly traded, their stock may not trade at high volumes, and prices can be volatile, which may restrict our ability to sell our positions. These privately held and publicly traded small businesses tend to lack management depth, to have limited or no history of operations and to not have attained profitability. Companies commercializing products enabled by disruptive science are especially risky, involving scientific, technological and commercialization risks. Because of the speculative nature of these investments, these securities have a significantly greater risk of loss than traditional investment securities. Some of our venture capital investments are likely to be complete losses or unprofitable, and some will never realize their potential. We have been and will continue to be risk seeking rather than risk averse in our approach to venture capital and other investments. Neither our investments nor an investment in our common stock is intended to constitute a balanced investment program.

**We have historically invested in sectors including life sciences, energy and electronics that are subject to specific risks related to each industry.**

We have historically invested the three largest portions of our portfolio in life sciences, energy and electronics companies. All of our life sciences investments can be characterized as BIOLOGY+ companies, which we refer to as investments in interdisciplinary life science companies where biology innovation is intersecting with innovations in areas such as electronics, physics, materials science, chemistry, information technology, engineering and mathematics. Our focus for new investments is in companies focused on BIOLOGY+, which often operate in life science-related industries and markets.

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

This life sciences industry is dominated by large multinational corporations with substantial greater financial and technical resources than generally will be available to the portfolio companies. Such large corporations may be better able to adapt to the challenges presented by continuing rapid and major scientific, regulatory and technological

changes as well as related changes in governmental and third-party reimbursement policies.

Within the life sciences industry, the development of products generally is a costly and time-consuming process. Many highly promising products ultimately fail to prove to be safe and effective. There can be no assurance that the research or product development efforts of our portfolio companies or those of their collaborative partners will be successfully completed, that specific products can be manufactured in adequate quantities at an acceptable cost and with appropriate quality, or that such products can be successfully marketed or achieve customer acceptance. There can be no assurance that a product will be relevant and/or be competitive with products from other companies following the costly, time-consuming process of its development.

The research, development, manufacturing, and marketing of products developed by some life sciences companies are subject to extensive regulation by numerous government authorities in the United States and other countries. There can be no assurance that products developed by the portfolio companies will ever be approved by such governmental authorities.

Many life sciences portfolio companies will depend heavily upon intellectual property for their competitive position. There can be no assurance that the portfolio companies will be able to obtain patents for key inventions. Moreover, within the life sciences industry, patent challenges are frequent. Even if patents held by the portfolio companies are upheld, any challenges thereto may be costly and distracting to the portfolio companies' management.

Some of the life sciences portfolio companies will be at least partially dependent for their success upon governmental and third-party reimbursement policies that are under constant review and are subject to change at any time. Any such change could adversely affect the viability of one or more portfolio companies.

We will continue to make follow-on investments in our energy companies. Additionally, our current and future BIOLOGY+ portfolio companies may address needs in energy-related industries and markets. Our energy portfolio consists of companies that commercialize and integrate products targeted at energy-related markets. There are risks in investing in companies that target energy-related markets, including the rapid and sometimes dramatic price fluctuations of commodities, particularly oil and sugar, and of public equities, the reliance on the capital and debt markets to finance large capital outlays, change in climate, including climate-related regulations, and the dependence on government subsidies to be cost-competitive with non-renewable or energy-efficient solutions. For example, the attractiveness of alternative methods for the production of biobutanol and biodiesel has been and may continue to be adversely affected by the rapid and dramatic decrease in the price of oil. Adverse developments in this market may significantly affect the value of our energy portfolio, and thus our venture capital portfolio as a whole.

We will continue to make follow-on investments in our electronics companies. Additionally, our current and future BIOLOGY+ portfolio companies may address needs in electronics-related industries and markets. Our electronics portfolio consists of companies that commercialize and integrate products targeted at electronics-related markets. There are risks in investing in companies that target electronics-related markets, including rapid and sometimes dramatic price erosion of products, the reliance on capital and debt markets to finance large capital outlays, including fabrication facilities, the reliance on partners outside of the United States, particularly in Asia, and inherent cyclicality of the electronics market in general. Additionally, electronics-related companies are currently out of favor with many venture capital firms. Therefore, access to capital may be difficult or impossible for companies in our portfolio that are pursuing these markets.

**The three main industry sectors around which our investments have developed are all capital intensive.**

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

**Our Board of Directors may change our investment objective, operating policies and strategies without prior notice or shareholder approval, the effects of which may be adverse.**

In 2013 we announced the refinement of our investment focus for new investments in BIOLOGY+ companies. We define BIOLOGY+ as investments in interdisciplinary life science companies where biology innovation is intersecting with innovations in areas such as electronics, physics, materials science, chemistry, information technology, engineering and mathematics. Our focus on BIOLOGY+ is not a fundamental policy, and we will not be required to give notice to shareholders prior to making a change from this focus.

Our Board of Directors has the authority to modify or waive our investment objective, current operating policies, investment criteria and strategies without prior notice and without shareholder approval. We cannot predict the effect any changes to our current operating policies, investment criteria and strategies would have on our business, net asset value, operating results and the value of our stock. However, the effects might be adverse, which could negatively impact our ability to pay you dividends and cause you to lose all or part of your investments.

We invest in illiquid securities and may not be able to dispose of them when it is advantageous to do so, or ever.

Most of our investments are or will be equity, equity-linked, or debt securities acquired directly from small businesses. These securities are generally subject to restrictions on resale or otherwise have no established trading market. The illiquidity of most of our portfolio of securities may adversely affect our ability to dispose of these securities at times when it may be advantageous for us to liquidate these investments. We may never be able to dispose of these securities.

In addition, we are typically subject to lock-up provisions that prohibit us from selling our investments into the public market for specified periods of time after IPOs. After a portfolio company completes an IPO, its shares are generally subject to lock-up restrictions for a period of time. These lock-up restrictions apply to us and our shares of the portfolio company, potentially including any shares purchased by us in the IPO, and generally include provisions that stipulate that we are not permitted to offer, pledge or sell our shares, including selling covered call options on our shares, prior to the expiration of the lock-up period. We are also prohibited from entering into securities lending arrangements for these securities during the lock-up period. The market price of securities that we hold may decline substantially before we are able to sell these securities.



We may also hold securities of privately held companies that transition to publicly traded companies through reverse mergers into publicly traded shell companies. In such transactions, holders of shares of the privately held company prior to the reverse merger may be subject to limitations on the sale of securities held including time and volume restrictions. These restrictions may limit our ability to dispose of these securities at times when it may be advantageous for us to liquidate these investments, and the market price of securities that we hold may decline substantially before we are able to sell these securities.

**Successful portfolio companies do not always result in positive investment returns.**

Depending on the amount and timing of our investments in our portfolio companies, even if a portfolio company is ultimately successful, the returns on our investment in such portfolio company may not be positive. Our portfolio companies often receive capital from venture capitalists and/or other investors in rounds of financing. Depending on the amount of capital that it takes to operate a company until it either becomes cash flow positive or seeks to exit through an IPO or M&A transaction, each round of financing may have different terms, including liquidation preferences and control over company decisions. Depending on which rounds of financings the Company participates in and the terms of the last round of financing, the investment returns for any particular round may be higher or lower than others. Furthermore, our portfolio companies often require more capital than originally expected, and the ultimate value of those companies at realization may not be greater than the capital invested. Each of these scenarios and others could lead to a realized loss on an investment in an ultimately successful company.

**Our investments in debt securities of portfolio companies may be extremely risky, and we could lose all or part of our investments.**

A portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its assets, which could trigger cross-defaults under other agreements and jeopardize our portfolio company's ability to meet its obligations under the debt securities that we hold. We may incur expenses to the extent necessary to seek recovery upon default or to negotiate new terms with a defaulting portfolio company. In addition, if a portfolio company goes bankrupt, even though we may have structured our interest as senior debt, depending on the facts and circumstances, including the extent to which we actually provided significant "managerial assistance" to that portfolio company, a bankruptcy court might recharacterize our debt holding and subordinate all or a portion of our claim to that of another creditor.

When we make an investment in a secured debt instrument of a portfolio company, we generally take a security interest in the available assets of the portfolio company, including the equity interests of its subsidiaries, which we expect to help mitigate the risk that we will not be repaid. However, there is a risk that the collateral securing our loans may decrease in value over time, may be difficult to sell in a timely manner, may be difficult to appraise and may fluctuate in value based upon the success of the business and market conditions, including as a result of the inability of the portfolio company to raise additional capital, and, in some circumstances, our lien could be

subordinated to claims of other creditors. In addition, deterioration in a portfolio company's financial condition and prospects, including its inability to raise additional capital, may be accompanied by deterioration in the value of the collateral for the loan. Consequently, the fact that a loan is secured does not guarantee that we will receive principal and interest payments according to the loan's terms, or at all, or that we will be able to collect on the loan should we be forced to enforce our remedies.

**To the extent we use debt to finance our investments, changes in interest rates could affect our cost of capital and net investment income.**

To the extent we borrow money to make investments, our net investment income will depend, in part, upon the difference between the rate at which we borrow funds and the return from invested funds. As a result, we can offer no assurance that a significant change in market interest rates will not have a material adverse effect on our net investment income in the event we use debt to finance our investments. In periods of rising interest rates, our cost of funds could increase, which could reduce our net investment income. In addition, an increase in interest rates would make it more expensive to use debt to finance our investments. As a result, a significant increase in market interest rates could increase our cost of capital, which would reduce our net investment income. A decrease in market interest rates may adversely impact our returns on our cash invested in treasury securities, which would reduce our net investment income and cash available to fund operations. We may also use the proceeds from borrowings to invest in non-income-producing investments. Under this scenario, we would incur costs associated with the borrowings without any income to offset those costs until such investment is monetized. It is possible we may not be able to cover the costs of such borrowings from the returns on those investments.

On September 30, 2013, the Company entered into the Loan Facility, which is a multi-draw credit facility that may be used by the Company to fund investments in portfolio companies. The Loan Facility requires payment of an unused commitment fee of one percent per annum on any unused borrowings. Borrowings under the Loan Facility bear interest at 10 percent per annum in cash. The Company has the option to have interest accrue at a rate of 13.5 percent per annum if the Company decides not to pay interest in cash when due. The Company currently plans to pay interest in cash if and when any borrowings are outstanding. As of December 31, 2014, there were no borrowings outstanding.

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

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



**Our portfolio companies face risks associated with international sales.**

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

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

The effect of global climate change may impact our operations and the operations of our portfolio companies.

There may be evidence of global climate change. Climate change creates physical and financial risk, and some of our portfolio companies may be adversely affected by climate change. For example, the needs of customers of energy companies vary with weather conditions, primarily temperature and humidity. To the extent weather conditions are affected by climate change, energy use could increase or decrease depending on the duration and magnitude of any changes. Increases in the cost of energy could adversely affect the cost of operations of our portfolio companies if the use of energy products or services is material to their business. A decrease in energy use owing to weather changes may affect some of our portfolio companies' financial condition through decreased revenues. Extreme weather conditions in general may disrupt our operations and the operations of our portfolio companies and require more system backups and redundancies, adding to costs, and can contribute to increased system stresses, including service interruptions.

**Risks related to our Company and an investment in our securities.**

**Our business may be adversely affected by the small size of our market capitalization.**

Changes in regulations of the financial industry have adversely affected coverage of small capitalization companies such as ours by financial analysts. A number of analysts that have covered us in the past are no longer able to continue to do so owing to changes in employment, to restrictions on the size of companies they are allowed to cover and/or their firms have shut down operations. An inability to attract analyst coverage may adversely affect the liquidity of our stock and our ability to raise capital from investors, particularly institutional investors. Our inability to access the capital markets on favorable terms, or at all, may adversely affect our future financial performance. The inability to obtain adequate financing could force us to seek debt financing, self-fund strategic initiatives or even forgo certain opportunities, which in turn could potentially harm our current and future performance.

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.

There is generally no public market for the private equity securities in which we invest. Pursuant to the requirements of the 1940 Act, we value all of the privately held equity and debt securities in our portfolio at fair value as determined in good faith by the Valuation Committee, a committee made up of all of the independent members of our Board of Directors, pursuant to Valuation Procedures established by the Board of Directors. Determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment pursuant to specified valuation principles and processes. We are required by the 1940 Act to value specifically each individual investment on a quarterly basis and record unrealized depreciation for an investment that we believe has become impaired. Conversely, we must record unrealized appreciation if we believe that a security has appreciated in value. Our valuations, although stated as a precise number, are necessarily within a range of values that vary depending on the significance attributed to the various factors being considered.

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

Without a readily ascertainable market value and because of the inherent uncertainty of valuation, the fair value that we assign to our investments may differ from the values that would have been used had an efficient market existed for the investments, and the difference could be material. Any changes in fair value are recorded in our Consolidated Statement of Operations as a change in the "Net (decrease) increase in unrealized depreciation on investments."

In the venture capital industry, even when a portfolio of early-stage, high-technology venture capital investments proves to be profitable over the portfolio's lifetime, it is common for the portfolio's value to undergo a so-called "J-curve" valuation pattern. This means that when reflected on a graph, the portfolio's valuation would appear in the shape of the letter "J," declining from the initial valuation prior to increasing in valuation. This J-curve valuation pattern results from write-downs and write-offs of portfolio investments that appear to be unsuccessful, prior to write-ups for portfolio investments that prove to be successful. Because early-stage small businesses typically have negative cash flow and are by their nature inherently fragile, a valuation process can more readily substantiate a loss of value than an increase in value. Even if our venture capital investments prove to be profitable in the long run, such J-curve valuation patterns could have a significant adverse effect on our net asset value per share and the value of our common stock in the interim. Over time, as we continue to make additional investments, this J-curve pattern may be less relevant for our portfolio as a whole, because the individual J-curves for each investment, or series of investments, may overlap with previous investments at different stages of their J-curves.





**We expect to continue to experience material write-downs of securities of portfolio companies.**

Write-downs of securities of our privately held companies have always been a by-product and risk of our business. We expect to continue to experience material write-downs of securities of privately held portfolio companies. Write-downs of such companies occur at all stages of their development. Such write-downs may increase in dollar terms, frequency and as a percentage of our net asset value as our dollar investment activity in privately held companies continues to increase, and the number of such holdings in our portfolio continues to grow. As the average size of each of our investments increases, the average size of our write-downs may also increase.

Option pricing models place a high weighting on liquidation preferences, which means that small differences in how the preferences are structured can have a material effect on the fair value of our securities at the time of valuation and also on future valuations should additional rounds of financing occur with senior preferences. As such, valuations calculated by option pricing models may not increase if 1) rounds of financing occur at higher prices per share, 2) liquidation preferences include multiples on investment, 3) the amount of invested capital is small and/or 4) liquidation preferences are senior to prior rounds of financing.

**Unfavorable regulatory changes could impair our ability to engage in liquidity events and dampen our returns.**

We rely on the ability to generate realized returns on our investments through liquidity events such as IPOs and M&A transactions.

When companies in which we have invested as private entities complete IPOs of their securities, these newly issued securities are by definition unseasoned issues. Unseasoned issues tend to be highly volatile and have uncertain liquidity, which may negatively affect their price. In addition, we are typically subject to lock-up provisions that prohibit us from selling our investments into the public market for specified periods of time after IPOs. The market price of securities that we hold may decline substantially before we are able to sell these securities. Government reforms that affect the trading of securities in the United States have made market-making activities by broker-dealers less profitable, which has caused broker-dealers to reduce their market-making activities, thereby making the market for unseasoned stocks less liquid than they might be otherwise.

We also invest in companies that may complete public listings through reverse mergers with publicly traded shell companies. The securities owned prior to the completion of the reverse merger are subject to sale restrictions of at least one year from the effective date of the reverse merger as long as the publicly traded company continues to comply with the requirements of Rule 144. In addition, stockholders deemed to be affiliates of the publicly traded company are subject to volume restrictions once the stock owned by those entities is tradable. Furthermore, in 2011, the SEC established new rules for "seasoning periods" for former shell companies to uplist to a national exchange.

These rules may negatively affect the liquidity of our stock of these companies as well as the ability of the publicly traded companies to raise additional capital, if needed. These factors could negatively affect the performance of the publicly traded companies and our returns on investments in these companies.

In addition, the structural changes in the public markets that currently value near-term cash flows and predictable revenues versus long-term prospects for growth, and the regulatory burden imposed on publicly traded companies by governments worldwide, have reduced the appetite for some of our portfolio companies to pursue IPOs or other steps that would increase the liquidity of our ownership in these portfolio companies. This trend may lengthen the time that our portfolio companies remain as privately held entities in our portfolio, and our returns on these investments may be dampened by the need or choice to seek monetization of such illiquid assets.

An inability to generate realized returns on our investments could negatively affect our liquidity, our reinvestment rate in new and follow-on investments and the value of our investment portfolio.

**We are subject to risks associated with our strategy of increasing assets under management by raising third-party funds to manage.**

We have announced our strategy to grow assets under management by raising one or more third-party funds to manage. It is possible that we will invest our capital alongside or through these funds in portfolio companies. There is no assurance when and if we will be able to raise such fund(s) or, if raised, whether they will be successful.

Our executive officers and employees, in their capacity as the investment advisor of a fund, may manage other investment funds in the same or a related line of business as we do. Accordingly, they may have obligations to such other entities, the fulfillment of which obligations may not be in the best interests of us or our shareholders.

**Our shares of common stock are trading at a discount from net asset value and may continue do so in the future.**

Shares of closed-end investment companies have frequently traded at a market price that is less than the net asset value that is attributable to those shares. In part as a result of adverse economic conditions and increasing pressure within the financial sector of which we are a part, our common stock traded below our net asset value per share during some periods in 2010 and consistently throughout 2011 through 2014. Our common stock may continue to trade at a discount to net asset value in the future. The possibility that our shares of common stock may trade at a discount from net asset value over the long term is separate and distinct from the risk that our net asset value will decrease. We cannot predict whether shares of our common stock will trade above, at, or below our net asset value. On December 31, 2014, our stock closed at \$2.95 per share, a discount of \$0.56, or 16.0 percent, to our net asset value per share of \$3.51 as of December 31, 2014. On March 13, 2015, our stock closed at \$3.18 per share, a discount of \$0.33, or 9.4 percent, to our net asset value per share as of December 31, 2014.



**Because we do not choose investments based on a strategy of diversification, nor do we rebalance the portfolio should one or more investments increase in value substantially relative to the rest of the portfolio, the value of our portfolio is subject to greater volatility than the value of companies with more broadly diversified investments.**

We do not choose investments based on a strategy of diversification. We also do not rebalance the portfolio should one of our portfolio companies increase in value substantially relative to the rest of the portfolio. Therefore, the value of our portfolio may be more vulnerable to events affecting a single sector or industry and, therefore, subject to greater volatility than a company that follows a diversification strategy. Accordingly, an investment in our common stock may present greater risk to you than an investment in a diversified company.

We are dependent upon key management personnel for future success, and may not be able to retain them.

None of our employees are subject to employment agreements. Our ability to attract and retain personnel with the requisite credentials, experience and skills will depend on several factors including, but not limited to, our ability to offer competitive wages, benefits and professional growth opportunities. Many of the entities with which we will compete for experienced personnel, including investment funds (such as venture capital funds) and traditional financial services companies, will have greater resources than us.

We are dependent upon the diligence and skill of our senior management and other key advisors for the selection, structuring, closing and monitoring of our investments. We utilize lawyers, and we utilize outside consultants to assist us in conducting due diligence when evaluating potential investments. There is generally no publicly available information about the companies in which we invest, and we rely significantly on the diligence of our employees and advisors to obtain information in connection with our investment decisions. Our future success, to a significant extent, depends on the continued service and coordination of our senior management team. The departure of any of our senior management or key advisors could materially adversely affect our ability to implement our business strategy. We do not maintain for our benefit any key-man life insurance on any of our officers or employees. The terms of our Loan Facility require that Douglas W. Jamison and Daniel B. Wolfe, or replacements suitable to our lender, devote substantially all of their time to Company matters, and failure to do so could trigger default.

**The failure in cyber security systems, as well as the occurrence of events unanticipated in our disaster recovery systems and management continuity planning, could impair our ability to conduct business effectively.**

The occurrence of a disaster such as a cyber attack, a natural catastrophe, an industrial accident, a terrorist attack or war, events unanticipated in our disaster recovery systems, or a support failure from external providers, could have an adverse effect on our ability to conduct business and on our results of operations and financial condition, particularly

if those events affect our computer-based data processing, transmission, storage, and retrieval systems or destroy data. If a significant number of our managers were unavailable in the event of a disaster, our ability to effectively conduct our business could be severely compromised.

We depend upon computer systems to perform necessary business functions. Despite our implementation of a variety of security measures, our computer systems could be subject to cyber attacks and unauthorized access, such as physical and electronic break-ins or unauthorized tampering. Like other companies, we may experience threats to our data and systems, including malware and computer virus attacks, unauthorized access, system failures and disruptions. If one or more of these events occurs, it could potentially jeopardize the confidential, proprietary and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our operations, which could result in damage to our reputation, financial losses, litigation, increased costs, regulatory penalties and/or shareholder dissatisfaction or loss.

**We are dependent on information systems and systems failures could disrupt our business, which may, in turn, negatively affect the market price of our common stock.**

Our business is dependent on our and third party communications and information systems. Any failure or interruption of those systems, including as a result of the termination of an agreement with any third-party service providers, could cause delays or other problems in our activities. Our financial, accounting, backup or other operating systems and facilities may fail to operate properly or become disabled or damaged as a result of a number of factors, including events that are wholly or partially beyond our control, and adversely affect our business. There could be:

- sudden electrical or telecommunications outages;
  
- natural disasters such as earthquakes, tornadoes and hurricanes;
  
- disease pandemics;
  
- events arising from local or larger scale political or social matters, including terrorist acts; and
  
- cyber attacks.

These events, in turn, could have a material adverse effect on our operating results and negatively affect the market price of our common stock.

**Our failure to make follow-on investments in our portfolio companies could impair the value of our portfolio.**

Following an initial investment in a portfolio company, we may make additional investments in that portfolio company as "follow-on" investments, in order to: (1) increase or maintain in whole or in part our ownership percentage; (2) exercise warrants, options or convertible securities that were acquired in the original or subsequent financing; or (3) attempt to preserve or enhance the value of our investment.



We may elect not to make follow-on investments or lack sufficient funds to make such investments. We have the discretion to make any follow-on investments, subject to the availability of capital resources. The failure to make a follow-on investment may, in some circumstances, jeopardize the continued viability of a portfolio company and our initial investment, or may result in a missed opportunity for us to increase our participation in a successful operation, or may cause us to lose some or all preferred rights pursuant to "pay-to-play" provisions that have become common in venture capital transactions. These provisions require proportionate investment in subsequent rounds of financing in order to preserve preferred rights such as anti-dilution protection, liquidation preferences and preemptive rights to invest in future rounds of financing. Even if we have sufficient capital to make a desired follow-on investment, we may elect not to make a follow-on investment because we may not want to increase our concentration of risk, because we prefer other opportunities or because we are inhibited by compliance with BDC requirements or the desire to maintain our tax status.

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.

Use of debt or preferred stock as a source of capital entails two primary risks. The first is the risk of leverage, which is the use of debt to increase the pool of capital available for investment purposes. The use of debt leverages our available common equity capital, magnifying the impact on net asset value of changes in the value of our investment portfolio. For example, a BDC that uses 33 percent leverage (that is, \$50 of leverage per \$100 of common equity) will show a 1.5 percent increase or decline in net asset value for each one percent increase or decline in the value of its total assets. The second risk is that the cost of debt or preferred stock financing may exceed the return on the assets the proceeds are used to acquire, thereby diminishing rather than enhancing the return to common shareholders. If we issue preferred shares or debt, the common shareholders would bear the cost of this leverage. To the extent that we utilize debt or preferred stock financing for any purpose, these two risks would likely make our total return to common shareholders more volatile. In addition, we might be required to sell investments, in order to meet dividend, interest or principal payments, when it might be disadvantageous for us to do so.

As provided in the 1940 Act and subject to some exceptions, we can issue debt or preferred stock so long as our total assets immediately after the issuance, less some ordinary course liabilities, exceed 200 percent of the sum of the debt and any preferred stock outstanding. The debt or preferred stock may be convertible in accordance with SEC guidelines, which might permit us to obtain leverage at more attractive rates. The requirement under the 1940 Act to pay, in full, dividends on preferred shares or interest on debt before any dividends may be paid on our common stock means that dividends on our common stock from earnings may be reduced or eliminated. An inability to pay dividends on our common stock could conceivably result in our ceasing to qualify as a RIC under the Code, which would, in most circumstances, be materially adverse to the holders of our common stock.

As of December 31, 2014, we had no debt outstanding pursuant to the Loan Facility, and we did not have any preferred stock outstanding.



**If we are unable to comply with the covenants or restrictions of the Loan Facility, our business could be materially adversely affected.**

The Loan Facility contains certain affirmative and negative covenants, including without limitation: (a) maintenance of certain minimum liquidity requirements; (b) maintenance of an eligible asset leverage ratio of not less than 4.0:1.0; (c) limitations on liens; (d) limitations on the incurrence of additional indebtedness; and (e) limitations on structural changes, mergers and disposition of assets (other than in the normal course of our business activities). Complying with these restrictions may prevent the Company from taking actions that we believe would help it to grow its business or are otherwise consistent with its investment objectives. These restrictions could also limit the Company's ability to plan for or react to market conditions or meet extraordinary capital needs or otherwise restrict corporate activities. For example, these restrictions, as currently in effect, would prohibit the Company from, or subject it to limitations on, incurring any additional indebtedness, which would include issuing any debt securities and buying back shares of the Company's stock.

The breach of any of the covenants or restrictions, unless cured within the applicable grace period, would result in a default under the Loan Facility that would permit the lenders thereunder to declare all amounts outstanding to be due and payable. Because the Loan Facility is secured by all the assets of the Company, in such an event, the Company may be forced to sell assets to repay such indebtedness. As a result, any default could cause the Company to sell portfolio company securities at a time that may not be advantageous and could have serious consequences to our financial condition. The Company may not be granted waivers or amendments to the Loan Facility if, for any reason, it is unable to comply with it, and the Company may not be able to refinance the Loan Facility on terms acceptable to it, or at all.

**We may expose ourselves to risks if we engage in hedging transactions.**

If we engage in hedging transactions, we may expose ourselves to risks associated with such transactions. We may utilize instruments such as forward contracts, currency options and interest rate swaps, caps, collars and floors to seek to hedge against fluctuations in the relative values of our portfolio positions from changes in market conditions, currency exchange rates and market interest rates. Hedging against a decline in the values of our portfolio positions does not eliminate the possibility of fluctuations in the values of such positions or prevent losses if the values of such positions decline. However, such hedging can establish other positions designed to gain from those same developments, thereby offsetting the decline in the value of such portfolio positions. Such hedging transactions may also limit the opportunity for gain if the values of the underlying portfolio positions should increase. It may not be possible to hedge against an exchange rate or interest rate fluctuation that is so generally anticipated that we are not able to enter into a hedging transaction at an acceptable price. Moreover, for a variety of reasons, we may not seek to establish a perfect correlation between such hedging instruments and the portfolio holdings being hedged. Any such imperfect correlation may prevent us from achieving the intended hedge and expose us to risk of loss. In addition, it may not be possible to hedge fully or perfectly against currency fluctuations affecting the value of securities denominated in non-U.S. currencies because the value of those securities is likely to fluctuate as a result of factors not related to currency fluctuations.



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

We are currently authorized to issue up to 2,000,000 shares of preferred stock, under terms and conditions determined by our Board of Directors. These shares would have a preference over our common stock with respect to dividends and liquidation. The statutory class voting rights of any preferred shares we would issue could make it more difficult for us to take some actions that might, in the future, be proposed by the Board and/or holders of common stock, such as a merger, exchange of securities, liquidation or alteration of the rights of a class of our securities, if these actions were perceived by the holders of the preferred shares as not in their best interests. The issuance of preferred shares convertible into shares of common stock might also reduce the net income and net asset value per share of our common stock upon conversion.

**Loss of status as a RIC could reduce our net asset value and distributable income.**

We have elected to qualify, have qualified and currently intend to continue to qualify as a RIC under the Code. As a RIC, we do not have to pay federal income taxes on our income (including realized gains) that is distributed to our shareholders. Accordingly, we are not permitted under accounting rules to establish reserves for taxes on our unrealized capital gains. If we failed to qualify for RIC status in 2014 or beyond, we would be taxed in the same manner as an ordinary corporation and distributions to our shareholders would not be deductible in computing our taxable income, which could materially adversely impact the amount of cash available for distribution to our shareholders. In addition, to the extent that we had unrealized appreciation, we would have to establish reserves for taxes, which would reduce our net asset value, accordingly. To qualify again to be taxed as a RIC in a subsequent year, we would be required to distribute to our shareholders our earnings and profits attributable to non-RIC years, reduced by an interest charge on 50 percent of such earnings and profits, which charge would be payable by us to the IRS. In addition, if we failed to qualify as a RIC for a period greater than two taxable years, then, in order to qualify as a RIC in a subsequent year, we would be required to elect to recognize and pay tax on any net built-in gain in our assets (the excess of aggregate gain, including items of income, over aggregate loss that would have been realized if we had sold our assets to an unrelated party for fair market value) or, alternatively, be subject to taxation on such built-in gain recognized for a period of 10 years.

We may elect not to be treated as a RIC if we are not able to qualify as a RIC in any given year.

In order to qualify for the special treatment accorded to RICs, we must meet certain income source, asset diversification and annual distribution requirements. Recent changes in our business, including our strategy of taking larger positions in our portfolio companies and increased holding periods to exit through IPOs or M&A transactions, have created more risk specifically relating to the asset diversification requirements of maintaining our special tax status. To qualify as a RIC, we must meet certain asset diversification requirements at the end of each quarter of our taxable year. Failure to meet these tests in any year may result in the loss of RIC status. Because our ownership

percentages in our portfolio have grown over the last several years, we have at least six companies with significant valuations that are not qualifying assets for the purpose of the RIC test. As long as the aggregate values of our non-qualifying assets remain below 50 percent of total assets, we will continue to qualify as a RIC. It becomes more difficult to pass this test when companies in our portfolio are successful and we want to invest more capital in those companies to increase our investment returns. Rather than selling portfolio companies that are performing well in order to pass our RIC diversification tests, we may opt instead to not qualify as a RIC. If we fail to qualify for special tax treatment accorded to RICs for failure of our RIC diversification tests, or for any other reason, we will be subject to corporate-level income tax on our income.

**A deemed dividend election could affect the value of our stock.**

If we, as a RIC, decide to make a deemed distribution of realized net capital gains and retain the net realized capital gains for any taxable year, also referred to as a deemed dividend, we would have to establish appropriate reserves for taxes that we would have to pay on behalf of shareholders. It is possible that establishing reserves for taxes could have a material adverse effect on the value of our common stock. Additionally, if we decide to make a deemed distribution and changes in tax law occur that would increase the dividend tax rates for individuals and corporations, the net benefit to shareholders from a deemed distribution could be adversely affected. Such changes, therefore, could reduce the overall benefit to our shareholders from our status as a RIC.

We operate in a heavily regulated environment, and changes to, or non-compliance with, regulations and laws could harm our business.

We are subject to substantive SEC regulations as a BDC. Securities and tax laws and regulations governing our activities may change in ways adverse to our and our shareholders' interests, and interpretations of these laws and regulations may change with unpredictable consequences. Any change in the laws or regulations that govern our business could have an adverse impact on us or on our operations. Changing laws, regulations and standards relating to corporate governance, valuation, public disclosure and market regulation, including the Sarbanes-Oxley Act of 2002 and the Dodd Frank Act, new SEC regulations, new federal accounting standards and Nasdaq Stock Market rules, create additional expense and uncertainty for publicly traded companies in general, and for BDCs in particular. These new or changed laws, regulations and standards are subject to varying interpretations in many cases because of their lack of specificity, and as a result, their application in practice may evolve over time, which may well result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices.

We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have and will continue to result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies, our reputation may be harmed. This increased regulatory burden is causing us to incur significant additional expenses and is time consuming for our management, which could have a material adverse effect on our financial performance.

**Market prices of our common stock will continue to be volatile.**

We expect that the market price of our common stock price will continue to be volatile. The price of the common stock may be higher or lower than the price you pay for your shares, depending on many factors, some of which are beyond our control and may not be directly related to our operating performance. These factors include the following:

- stock market and capital markets conditions;

• internal developments in our Company with respect to our personnel, financial condition and compliance with all applicable regulations;

- announcements regarding any of our portfolio companies;

- announcements regarding developments in the life sciences-, energy- or electronics-related fields in general;

• announcements regarding government funding and initiatives associated with the development of life sciences-, energy- or electronics-related products;

- a mismatch between the long-term nature of our business and the short-term focus of many investors;

• significant volatility in the market price and trading volume of securities of BDCs, RICs or other financial services companies;

• changes in regulatory policies or tax guidelines with respect to BDCs or RICs; general economic conditions and trends; and/or

- departures of key personnel.

We will not have control over many of these factors, but expect that our stock price may be influenced by them. As a result, our stock price may be volatile, and you may lose all or part of your investment. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. Due to the potential volatility of our stock price, we may therefore be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business.



**Quarterly results fluctuate and are not indicative of future quarterly performance.**

Our quarterly operating results fluctuate as a result of a number of factors. These factors include, among others, variations in and the timing of the recognition of realized and unrealized gains or losses, the degree to which we and our portfolio companies encounter competition in our markets and general economic and capital markets conditions. As a result of these factors, results for any one quarter should not be relied upon as being indicative of performance in future quarters.

Investment in foreign securities could result in additional risks.

We may invest in foreign securities, and we currently have one investment in a foreign security. When we invest in securities of foreign issuers, we may be subject to risks not usually associated with owning securities of U.S. issuers. These risks can include fluctuations in foreign currencies, foreign currency exchange controls, social, political and economic instability, differences in securities regulation and trading, expropriation or nationalization of assets and foreign taxation issues. In addition, changes in government administrations or economic or monetary policies in the United States or abroad could result in appreciation or depreciation of our securities and could favorably or unfavorably affect our operations. It may also be more difficult to obtain and enforce a judgment against a foreign issuer. Any foreign investments made by us must be made in compliance with U.S. and foreign currency restrictions and tax laws restricting the amounts and types of foreign investments.

Although most of our investments are denominated in U.S. dollars, our investment that is denominated in a foreign currency is subject to the risk that the value of a particular currency may change in relation to the U.S. dollar, in which currency we maintain financial statements and valuations. Among the factors that may affect currency values are trade balances, the level of short-term interest rates, differences in relative values of similar assets in different currencies, long-term opportunities for investment and capital appreciation and political developments.

Investing in our stock is highly speculative and an investor could lose some or all of the amount invested.

Our investment objectives and strategies result in a high degree of risk in our investments and may result in losses in the value of our investment portfolio. Our investments in small businesses are highly speculative and, therefore, an investor in our common stock may lose his or her entire investment. The value of our common stock may decline and may be affected by numerous market conditions, which could result in the loss of some or all of the amount invested in our common stock. The securities markets frequently experience extreme price and volume fluctuations that affect market prices for securities of companies in general, and technology and very small capitalization companies in particular. Because of our focus on the technology and very small capitalization sectors, and because we are a very small capitalization company ourselves, our stock price is especially likely to be affected by these market conditions. General economic conditions, and general conditions in nanotechnology and in the semiconductor and information technology, life sciences, materials science and other high-technology industries, including energy, may also affect the price of our common stock.

**Our strategy of writing covered calls and buying put options on public portfolio company securities held by us could result in us receiving a lower return for such investments than if we had not employed such strategy.**

There are several risks associated with transactions in options on securities. For example, there are significant differences between the securities and options markets that could result in an imperfect correlation between these markets, causing a given transaction not to achieve its objectives. A decision as to whether, when and how to use options involves the exercise of skill and judgment, and even a well-conceived transaction may be unsuccessful to some degree because of market behavior or unexpected events. As the writer of a covered call option, the Company forgoes, during the option's life, the opportunity to profit from increases in the market value of the security covering the call option above the sum of the premium and the strike price of the call, but has retained the risk of loss should the price of the underlying security decline. The writer of an option has no control over the time when it may be required to fulfill its obligation as a writer of the option. Once an option writer has received an exercise notice, it cannot effect a closing purchase transaction in order to terminate its obligation under the option and must deliver the underlying security at the exercise price.

As the buyer of a put option, we may incur losses if the price per share of the underlying stock to that option is above the strike price of the put option at the time of expiration, which would result in our put option expiring without value. Such expiration would reduce our overall returns on our investment in those publicly traded securities once they are sold.

**The Board of Directors intends to grant restricted stock pursuant to the Amended and Restated Harris & Harris Group, Inc. 2012 Equity Incentive Plan (the "Stock Plan"). These equity awards may have a dilutive effect on existing shareholders.**

In accordance with the Stock Plan, the Company's Board of Directors plans to grant equity awards in the form of restricted stock from time to time for up to 10 percent of the total shares of stock issued and outstanding as of the effective date of the Stock Plan (June 7, 2012). Issuance of shares of restricted stock results in existing shareholders owning a smaller percentage of the shares outstanding.

You have no right to require us to repurchase your shares.

You do not have the right to require us to repurchase your shares of common stock.

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

Sales of a substantial number of shares of our common stock in offerings, such as follow-on public offerings, registered direct or PIPE transactions, or rights offerings, or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities.

**Item 1B. Unresolved Staff Comments.**

None.

37

**Item 2. Properties.**

The Company maintains its offices at 1450 Broadway, New York, New York 10018, where it leases approximately 6,900 square feet of office space pursuant to a lease agreement expiring on December 31, 2019. (See "Note 11. Commitments and Contingencies" contained in "Item 8. Consolidated Financial Statements and Supplementary Data.")

We believe that our office facilities are suitable and adequate for our business as it is contemplated to be conducted.

**Item 3. Legal Proceedings.**

The Company is not currently a party to any legal proceedings.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.****Market Information**

Our common stock is traded on the Nasdaq Global Market under the symbol "TINY." The following table sets forth the range of the high and low sales price of the Company's shares during each quarter of the last two fiscal years and the closing share price as a percentage of net asset value, as reported by the Nasdaq Global Market. The quarterly stock prices quoted represent interdealer quotations and do not include markups, markdowns or commissions.

Quarter Ended	Market Price		Net Asset Value ("NAV") Per Share at End of Period	Premium or (Discount) as a % of NAV	
	High	Low		High	Low
March 31, 2014	\$3.94	\$2.83	\$ 3.73	5.6 %	(24.1 )%
June 30, 2014	\$3.91	\$3.12	\$ 3.87	1.0 %	(19.4 )%
September 30, 2014	\$3.43	\$2.90	\$ 3.85	(10.9 )%	(24.7 )%
December 31, 2014	\$3.09	\$2.51	\$ 3.51	(12.0 )%	(28.5 )%
March 31, 2013	\$3.94	\$3.35	\$ 4.11	(4.1 )%	(18.5 )%
June 30, 2013	\$3.70	\$3.01	\$ 4.24	(12.7 )%	(29.0 )%
September 30, 2013	\$3.23	\$2.95	\$ 4.18	(22.7 )%	(29.4 )%
December 31, 2013	\$3.26	\$2.95	\$ 3.93	(17.0 )%	(24.9 )%

Shares of BDCs may trade at a market price that is less than the value of the net assets attributable to those shares. The possibility that our shares of common stock will trade at premiums that are unsustainable over the long term or at a discount from net asset value is separate and distinct from the risk that our net asset value will decrease. Historically, our shares of common stock have traded at times at a discount and at other times at a premium to net asset value. For the last two years, our stock has generally traded at a discount to net asset value. The last reported price for our common stock on December 31, 2014, was \$2.95 per share, which was a 16.0 percent discount to our net asset value of \$3.51 as of December 31, 2014.

**Shareholders**

As of March 12, 2015, there were approximately 112 holders of record and approximately 14,505 beneficial owners of the Company's common stock.

## Dividends

We did not pay a cash dividend or declare a deemed dividend for 2014 or 2013. For more information about deemed dividends, please refer to the discussion under "Tax Status."

## Securities Authorized for Issuance Under Equity Compensation Plans

## EQUITY COMPENSATION PLAN INFORMATION

As of December 31, 2014

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights <sup>(1)</sup>	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in Column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,423,912	\$ 9.77	(2)
Equity compensation plans not approved by security holders	-	-	-
<b>TOTAL</b>	<b>1,423,912</b>	<b>\$ 9.77</b>	<b>(2)</b>

<sup>(1)</sup> Represents shares subject to options.

<sup>(2)</sup> The Company's Stock Plan permits the issuance of stock options and restricted stock in an aggregate amount of up to 20 percent of our issued and outstanding common stock (the "Plan Maximum Shares") as of the effective date of the Stock Plan (June 7, 2012). Under the Stock Plan, all of the Plan Maximum Shares are available for grants of stock options, and half of the Plan Maximum Shares (up to 10 percent of our issued and outstanding common stock as of the effective date of the Stock Plan) is available for grants of restricted stock. As of December 31, 2014, there were 3,610,713 shares remaining available for issuance under the Stock Plan, 1,934,565 of which were available for grant in the form of restricted stock. If any shares subject to an award granted under the Stock Plan are forfeited, cancelled,



exchanged or surrendered, or if an award terminates or expires without a distribution of shares, those shares will again be available for awards under the Stock Plan.

### **Performance Graph**

The graph below compares the cumulative five-year total return of holders of the Company's common stock with the cumulative total returns of the Nasdaq Composite index and the Nasdaq Financial index. We chose broader indices for comparison because we make investments in multiple industries, and we do not believe there is an appropriate index of companies with an investment strategy similar to our own with which to compare the return on our common stock. The graph assumes that the value of the investment in the Company's common stock and in each of the indexes (including reinvestment of dividends) was \$100 on December 31, 2009, and tracks it through December 31, 2014.

	12/09	12/10	12/11	12/12	12/13	12/14
Harris & Harris Group, Inc.	100.00	95.84	75.71	72.21	65.21	64.55
NASDAQ Composite	100.00	117.61	118.70	139.00	196.83	223.74
NASDAQ Financial	100.00	113.40	103.94	121.51	168.97	177.13

*The stock price performance included in this graph is not necessarily indicative of future stock price performance.*

*Source: Research Data Group, Inc.*

#### **Stock Transfer Agent**

American Stock Transfer & Trust Company, 59 Maiden Lane, New York, New York 10038 (Telephone 800-937-5449, Attention: Mr. Paul O'Leary) serves as our transfer agent. Certificates to be transferred should be mailed directly to the transfer agent, preferably by registered mail.

**Item 6. Selected Financial Data.**

The information below was derived from the audited Consolidated Financial Statements included in this report and in previous annual reports filed with the SEC. This information should be read in conjunction with those Consolidated Financial Statements and Supplementary Data and the notes thereto. These historical results are not necessarily indicative of the results to be expected in the future.

**Financial Position as of December 31:**

	2014	2013	2012	2011	2010
Total assets	\$112,094,861	\$125,063,946	\$131,990,250	\$150,343,653	\$149,289,168
Total liabilities	\$2,440,434	\$2,362,371	\$3,553,476	\$4,645,246	\$2,435,256
Net assets	\$109,654,427	\$122,701,575	\$128,436,774	\$145,698,407	\$146,853,912
Net asset value per outstanding share	\$3.51	\$3.93	\$4.13	\$4.70	\$4.76
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	31,280,843	31,197,438	31,116,881	31,000,601	30,878,164

**Operating Data for Year Ended December 31:**

	2014	2013	2012	2011	2010
Total investment income	\$517,800	\$470,902	\$722,227	\$702,765	\$446,038
Total expenses <sup>1</sup>	\$8,419,527	\$8,493,108	\$9,525,570	\$9,041,130	\$8,001,845
Net operating loss	\$(7,901,727 )	\$(8,022,206 )	\$(8,803,343 )	\$(8,338,365 )	\$(7,555,807 )
Total tax expense (benefit)	\$17,896	\$27,994	\$15,236	\$6,922	\$4,461
Net realized (loss) gain income from investments	\$(5,083,625 )	\$18,516,268	\$2,406,433	\$2,449,705	\$(3,740,518 )

Net (increase) decrease in unrealized depreciation on investments	\$ (585,068 )	\$ (18,283,020)	\$ (13,589,990)	\$ 2,347,297	\$ 21,883,175
Net (decrease) increase in net assets resulting from operations	\$ (13,570,420)	\$ (7,788,958 )	\$ (19,986,900)	\$ (3,541,363)	\$ 10,586,850
(Decrease) increase in net assets resulting from operations per average outstanding share	\$ (0.43 )	\$ (0.25 )	\$ (0.65 )	\$ (0.12 )	\$ 0.34

<sup>1</sup> Included in total expenses is non-cash, stock-based compensation expense of \$857,006 in 2014; \$1,249,756 in 2013; \$2,928,943 in 2012; \$1,894,800 in 2011; and \$2,088,091 in 2010.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The information contained in this section should be read in conjunction with the Company's 2014 Consolidated Financial Statements and notes thereto.

### **Cautionary Statement Regarding Forward-Looking Statements**

This Annual Report on Form 10-K contains forward-looking statements that involve substantial risks and uncertainties. These forward-looking statements are not historical facts, but rather are based on current expectations, estimates and projections about the Company, our current and prospective portfolio investments, our industry, our beliefs, and our assumptions. Words such as "anticipates," "expects," "intends," "plans," "will," "may," "continue," "believes," "seeks," "estimates," "would," "could," "should," "targets," "projects," and variations of these words and similar expressions are intended to identify forward-looking statements. The forward-looking statements contained in this Annual Report involve risks and uncertainties, including statements as to:

- our future operating results;
- our business prospects and the prospects of our portfolio companies;
- the impact of investments that we expect to make;
- our contractual arrangements and relationships with third parties;
- the dependence of our future success on the general economy and its impact on the industries in which we invest;
- the ability of our portfolio companies to achieve their objectives;
- our expected financings and investments;
- the adequacy of our cash resources and working capital; and
- the timing of cash flows, if any, from the operations and/or monetization of our positions in our portfolio companies.

These statements are not guarantees of future performance and are subject to risks, uncertainties, and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements, including without limitation:

- an economic downturn could impair our portfolio companies' ability to continue to operate, which could lead to the loss of some or all of our investments in such portfolio companies;
- a contraction of available credit and/or an inability to access the equity markets could impair our investment activities;

- interest rate volatility could adversely affect our results, particularly if we elect to use leverage as a material part of our investment strategy;
- currency fluctuations could adversely affect the results of our investments in foreign companies, particularly to the extent that we receive payments denominated in foreign currency rather than U.S. dollars; and
- the risks, uncertainties and other factors we identify in "Risk Factors" and elsewhere in this Annual Report on Form 10-K and in our other filings with the SEC.

Although we believe that the assumptions on which these forward-looking statements are based are reasonable, any of those assumptions could prove to be inaccurate, and as a result, the forward-looking statements based on those assumptions also could be inaccurate. Important assumptions include our ability to originate new investments, certain margins and levels of profitability and the availability of additional capital. In light of these and other uncertainties, the inclusion of a projection or forward-looking statement in this Annual Report on Form 10-K should not be regarded as a representation by us that our plans and objectives will be achieved. These risks and uncertainties include those described or identified in "Risk Factors" and elsewhere in this Annual Report on Form 10-K. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Annual Report on Form 10-K.

## **Background and Overview**

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

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

We believe we provide five core benefits to our shareholders. First, we are an established firm with a positive track record of investing in venture capital-backed companies as further discussed in "Investments and Current Investment Pace" on page 60. Second, we provide shareholders with access to disruptive science-enabled companies, particularly ones that are enabled by BIOLOGY+, that would otherwise be difficult to access or inaccessible for most current and potential shareholders. Third, we have an existing portfolio of companies at varying stages of maturity that provide for a potential pipeline of investment returns over time. Fourth, we are able to invest opportunistically in a range of types of securities to take advantage of market inefficiencies. Fifth, we provide access to venture capital investments in a vehicle that, unlike private venture capital firms, has permanent capital, is transparent and is liquid.





We build transformative companies from disruptive science. We make venture capital investments in companies enabled by multidisciplinary, disruptive science. We define venture capital investments as the money and resources made available to privately held and publicly traded small businesses with exceptional growth potential.

In 2002, we focused our efforts investing in companies that were enabled at the micro and nanoscale. Many of the disruptive scientific breakthroughs that are the basis of the transformative companies we build occur at the nanoscale. This focus permitted the Company to become a leader investing in this emerging space. Additionally, our interdisciplinary scientific backgrounds led us to identify interesting breakthroughs that were occurring ever more often at the intersection of different scientific disciplines.

Two things have become clear to us over the past six years. First, many of the most interesting scientific breakthroughs are occurring at the intersection of different scientific disciplines, usually with biology as one of these disciplines. Two, companies that intersect with healthcare or the life sciences are yielding increased venture capital returns. In our own portfolio, companies in the life science sector have outperformed portfolio companies in the electronics and energy sectors significantly since 2002. Thus, beginning in 2008, the majority of our investments have been in companies that we define as BIOLOGY+, which refers to investments in interdisciplinary life science companies where biology innovation is intersecting with innovations in areas such as electronics, physics, materials science, chemistry, information technology, engineering and mathematics. We expect our future investments to be within the category of BIOLOGY+.

Our business model is simple. We help build transformative companies by being the first investors, building value in these companies over a multi-year period, realizing returns from our investments through acquisitions or IPOs, and reinvesting some of the returns on our investments into new portfolio companies that can drive future growth. We believe our evergreen structure is a competitive advantage over traditional, time-limited venture capital private partnerships as most of those entities do not have permanent capital to invest in portfolio companies. We believe we are a unique company with our focus on being actively involved investors in the formation and building of early-stage companies founded on disruptive science as a liquid, U.S. exchange listed, publicly traded company.

As of December 31, 2014, we had 26 equity-focused companies in our portfolio that have yet to complete liquidity events (e.g., IPOs or M&A transactions). This does not include 1) our publicly traded shares of Solazyme, Inc., and Champions Oncology, Inc.; 2) our publicly traded shares of Enumeral Biomedical Holdings, Inc., which are subject to restrictions on their sale; 3) our two venture debt deals, GEO Semiconductor Inc., and NanoTerra, Inc.; and 4) our rights to milestone payments from Amgen, Inc., Laird Technologies, Inc., and Canon, Inc. As of December 31, 2014, we valued our 26 privately held equity-focused companies at \$76,315,454. Including the companies referenced above, we valued our total venture capital portfolio at \$89,764,840 as of December 31, 2014. At December 31, 2014, from first dollar in, the average and median holding periods for the 26 privately held equity-focused investments were 5.7 years and 5.6 years, respectively. Historically, as measured from first dollar in to last dollar out, the average and median holding periods for the 72 investments we have exited were 4.5 years and 3.5 years, respectively.

Our execution strategy over the next five years has four parts: 1) Realize returns to increase shareholder value; 2) Invest for growth to increase shareholder value; 3) Partner to more effectively create value; and 4) Return value to our shareholders.

### **Realize**

"Realize" refers to realizing value in our venture capital portfolio. Since our investment in Otisville in 1983 through December 31, 2014, we have made a total of 101 equity-focused venture capital investments. We have completely exited 72 and partially exited three of these 101 investments, recognizing aggregate net realized gains of \$83,710,353 on invested capital of \$129,669,354, or 1.6 times invested capital. For the securities of the 26 companies in our equity-focused portfolio held at December 31, 2014, we have net unrealized depreciation of \$25,866,561 on invested capital of \$102,182,015. We have aggregate net realized gains on our exited companies, offset by unrealized depreciation for our 26 currently held equity-focused investments of \$57,843,792 on invested capital of \$231,851,369.

The amount of net realized gains includes:

Realized gains of \$19,957,324 from the sale of BioVex Group, Inc., to Amgen, Inc., the sale of Innovalight, Inc., to DuPont, the sale of Crystal IS, Inc., to Asahi Kasei Group, the sale of Xradia, Inc., to Carl Zeiss AG, and the sale of the semiconductor lithography equipment business of Molecular Imprints, Inc., to Canon, Inc. We had invested a total of \$18,231,340 in these five portfolio companies;

Realized gains of \$17,801,322 from the sale of shares of Solazyme, Inc., on invested capital of \$5,326,098. In addition, we generated \$1,757,610 in realized gains on our sale and/or purchase of written call option and put option contracts covered by our shares of Solazyme, Inc.;

Realized gains of \$296,972 from the sale of shares of Champions Oncology, Inc., on invested capital of \$576,971;

Realized gains of \$536,813 from rights to milestone payments resulting from the achievement during the third quarter of 2014 of the first milestone associated with Amgen, Inc.'s acquisition of BioVex Group, Inc.;

Realized loss of \$4,839,811, including call options, on our investment in NeoPhotonics Corporation on invested capital of \$7,299,590;

Realized loss of \$7,299,533 on our investment in Kovio, Inc., on invested capital of \$7,299,533. On January 21, 2014, substantially all of Kovio's assets were sold by Square 1 Bank, Kovio's secured creditor, to Thin Film Electronics ASA. Our shares were subsequently declared worthless on February 19, 2014; and

Realized loss of \$4,488,576 on our investment in Contour Energy Systems, Inc., on invested capital of \$4,509,995. On August 15, 2014, the stockholders of Contour Energy Systems were given official notice of its liquidation and dissolution, which was approved by its board of directors following the approval of the majority of the stockholders.

The aggregate net realized gains and the cumulative invested capital do not reflect the cost or value of our freely tradable shares of Solazyme, Inc., and Champions Oncology, Inc., that we owned as of December 31, 2014. The aggregate net realized gains also do not include potential milestone payments that could occur as part of the acquisitions of BioVex Group, Inc., Nextreme Thermal Solutions, Inc., or Molecular Imprints, Inc., at points in time in the future. If these amounts were included as of December 31, 2014, our aggregate net realized gains and cumulative invested capital from 1983 through December 31, 2014, would be \$90,164,061 and \$133,797,360, respectively, or 1.7 times invested capital. These amounts also do not include our shares of Enumeral Biomedical Holdings, Inc., that, while traded publicly, are restricted and/or are subject to lock-up agreements.

***Recent and Potential Liquidity Events From Our Portfolio as of December 31, 2014***

During 2014, we received escrow payments totaling \$2,374,827 from Carl Zeiss AG's acquisition of Xradia, Inc., which was completed on July 19, 2013.

On April 18, 2014, Canon, Inc., completed its acquisition of Molecular Imprints, Inc.'s semiconductor lithography equipment business. We received \$6,486,461 at the close of the transaction and could receive an additional \$625,000 from amounts held in escrow as well as up to \$1.7 million upon the achievement of certain milestones. We have not received any milestone payments as of December 31, 2014, and there can be no assurance as to the timing and how much of this amount we will ultimately realize in the future, if any. With the closing of the transaction, a new spin-out company, which retained the name "Molecular Imprints, Inc.," was formed. This new company will continue development and commercialization of nanoscale patterning in consumer and biomedical applications. We are a shareholder of this new company. As of December 31, 2014, we valued potential milestone payments from the sale of Molecular Imprints at \$628,948.

As of December 31, 2014, we valued the remaining potential milestone payments from the sale of BioVex Group, Inc., at \$2,564,917. If all the remaining milestone payments were to be paid by Amgen, Inc., we would receive an additional \$7,455,438. There can be no assurance as to the timing and how much of this amount we will ultimately realize in the future. On October 2, 2014, Amgen notified the Stockholder Agent associated with the acquisition of BioVex that the BLA filing milestone was met on September 26, 2014, which resulted in a payment of \$2,070,955 in November of 2014.

As of December 31, 2014, we valued potential milestone payments from the sale of Nextreme Thermal Solutions, Inc., to Laird Technologies, Inc., at \$0.

On July 31, 2014, Enumeral Biomedical Corp. completed a reverse merger into a publicly traded shell company, Enumeral Biomedical Holdings, Inc. The operations of Enumeral Biomedical Corp. became those of the surviving entity. Simultaneously with the merger, the Company made a \$1.5 million investment in Enumeral Biomedical Holdings. Enumeral Biomedical Holdings is traded publicly on the OTC market under the symbol ENUM. The Company's shares of Enumeral Biomedical Holdings are subject to restrictions on transfer, and we are also subject to a lock-up agreement that restricts our ability to trade these shares, exclusive of the general restriction on the transfer of unregistered securities. The lock-up period on our 7,966,368 shares of Enumeral Biomedical Holdings expires on January 31, 2016. ENUM's stock closed trading on March 13, 2015, at \$0.78 per share.

On August 1, 2014, the Company received \$549,238 in payment of the outstanding principal, interest and warrants of OHSO Clean, Inc.

Our companies often plan for and/or begin the process of pursuing potential sales and/or IPOs of those companies by hiring bankers and/or advisors to attempt to pursue such liquidity events. We consider these efforts to be in the ordinary course of business for those companies until the potential and timing of a transaction become tangible through events such as acceptance of letters of intent to acquire a company and/or the beginning of a road show to pursue an IPO.

We note that on March 3, 2015, OpGen, Inc., publicly filed a registration statement on Form S-1 for an IPO. The company has yet to begin a road show for the potential offering, and there can be no certainty that this offering is completed successfully.

### ***Strategy for Managing Publicly Traded Positions***

Our equity-focused portfolio companies may seek to raise capital and provide liquidity to shareholders through IPOs. It is generally rare that pre-IPO investors are afforded the ability to sell a portion of shares owned in the IPO. These pre-IPO shares, and sometimes shares purchased in the IPO by us, are often subject to lock-up provisions that prevent the sale of those shares, options against those shares or other transactions associated with those shares until expiration of the lock-up period, which is often 180 days from the date of a standard IPO. This lock-up period may be longer in other public offering transactions or transitions from a privately held company to a publicly traded company through processes such as a reverse merger with a publicly traded shell company. We commonly plan to hold our shares of our publicly traded portfolio companies following the expiration of the lock-up restrictions if we believe that the prospects for future growth of the portfolio company and the underlying value of our shares are as great or greater than other opportunities we are currently encountering. We believe we are able to make such assessments using our extensive knowledge of the companies having actively worked with them and their management teams over multiple years as pre-IPO investors. As such, we may hold our shares of publicly traded portfolio companies for extended periods of time from the date of IPO. That said, we may also elect to sell our shares of publicly traded companies before such growth has occurred if we believe there are better growth opportunities for that capital or if we require that capital to make other investments and/or to fund operations of the Company.

In situations where a company becomes publicly traded through a reverse merger with a publicly traded shell company, we may be subject to additional restrictions on the sale of the securities under Rule 144. This rule stipulates that shares of the new publicly traded company cannot be sold outside of a registration statement unless the publicly traded company is current on its periodic filings with the SEC (other than Form 8-K filings) and a period of time of one year from the date of the filing of Form 10 information occurs. This date of filing is often set by the announcement of the reverse merger in an expanded Form 8-K that includes Form 10 information. An additional limitation is that there are restrictions on the volume of sales permitted by affiliates of the publicly traded company following the one-year period discussed above. Affiliates are those who are deemed to have control of the company. There is a rebuttable presumption that such control is achieved through ownership of more than 10 percent of the public company's class of voting securities or by serving as directors or officers of the company. We may be considered affiliates of these companies and, therefore, subject to these volume restrictions on the sale of our positions in these companies.

Following the expiration of the lock-up restrictions, we may pursue the sale of call options covered by our ownership of shares in our publicly traded portfolio companies. The Company will only "sell" or "write" options on common stocks held in the Company's portfolio. We will not sell "naked" call options, *i.e.*, options representing more shares of the stock than are held in the portfolio. These call options give the buyer the right to purchase our stock at a given price, the "strike price," prior to a specific date, the "expiration date." A call option whose strike price is above the

current price of the underlying stock is called "out-of-the-money." A call option whose strike price is below the current price of the underlying stock is called "in-the-money." When stocks in the portfolio rise, call options that were out-of-the-money when written may become in-the-money, thereby increasing the likelihood that they could be exercised, and we would be forced to sell the stock. The opposite would occur for an in-the-money option that would become out-of-the-money if the stock were to fall below the strike price of the option. We have used and currently plan to continue to use both in-the-money and out-of-the-money options as part of our strategy for managing our ownership in publicly traded portfolio companies.

We may also purchase put options as a method of limiting the downside risk that the price per share of these companies may decrease substantially from current levels. A put option gives its holder the right to sell a specified number of shares of a specific security at a specific price (known as the exercise strike price) by a certain date. The buyer of a put option is betting that the price of the security will decrease before the option expires. The risk for us as the option holder is that the option expires unexercised, and we have lost the money spent on buying the option.

For conventional listed call options, the options' expiration dates are commonly up to nine months from the date the call options are first listed for trading. Longer-term call options can have expiration dates up to three years from the date of listing. We currently expect the majority of written call options to be ones with expirations of equal to or shorter than one year from the date the call option is first listed for trading.

We believe this strategy of selling covered call options on our publicly traded portfolio companies provides at least three benefits:

1) We receive payment of a premium in cash at the time of the sale of the call option. The amount of the premium received is negotiated between the buyer and us and is influenced generally by the market price of the underlying stock, the volatility of the stock and the length of time between the date of sale of the call option and the expiration date. If the option expires out-of-the-money, we retain the premium as a gain on our investment.

2) If the option is exercised, it enables the monetization of the stock held by us in an orderly transaction that yields known returns. Our publicly traded portfolio companies currently trade at small average daily volumes of shares compared with our positions in these companies. As such, a decision by us to sell a portion or all of our shares in these companies in the public markets through brokers could negatively affect the price at which we would be able to sell these shares and, therefore, our ultimate returns. The sale of a call option sets a price at which our shares would sell if the option is exercised, which negates the potential impact of illiquidity or other market dynamics on our returns from the sale of these shares. That said, it also sets an upper limit for the proceeds we would receive in such sale. We plan to enter into such contracts at a price per share and in a timeframe that we would be willing to sell those shares. While we may repurchase call options when advantageous to us, we commonly do not sell call options with the expectation that we will repurchase them at a future date.



The sale of options may help generate interest and liquidity in the stock of our publicly traded portfolio companies. Current market dynamics make it difficult for small capitalization stocks to attract interest from institutional and 3)retail investors. This difficulty leads to low average trading volumes and low liquidity options for existing shareholders. We believe the sale of call options may aid in increasing the interest and liquidity in the stock of these companies and may be beneficial to our future potential returns on these investments.

During the year ended December 31, 2014, our strategy for managing our publicly traded positions generated \$119,697 in net cash proceeds from premiums on call options sold of Solazyme, Inc. We also sold 117,834 shares of Solazyme in open market transactions for proceeds, net of commission, of \$1,407,520. The net increase in our primary liquidity from these transactions was \$1,527,217. Through December 31, 2014, we have generated \$2,469,676 in net cash premiums on call options sold and put options purchased of Solazyme since the company completed an IPO in May 2011. We have sold a total of 2,254,149 shares of Solazyme since its IPO for net proceeds, after commission, of \$22,400,495 or an average sale price of \$9.94 per share. Including premiums from call and put options, the average sale price for these shares was \$11.03 per share. Our cost basis in Solazyme is \$2.36 per share.

During the year ended December 31, 2014, we sold 575,756 shares of our position in Champions Oncology, Inc., in open market transactions for net proceeds, after commission, of \$636,259 or an average sale price of \$1.11 per share. Our average cost basis in Champions is \$0.67 per share.

These increases in primary liquidity are important for our efforts to continue to fund existing and new portfolio companies that could generate future investment returns.

### ***Maturity of Current Equity-Focused Venture Capital Portfolio***

There are three main drivers of our potential growth in value over the next four years. First, we have a larger portfolio of more mature companies than we have had historically. Second, we believe the quality of our existing portfolio is stronger than it has been historically. Third, we own larger percentages of the companies in the existing portfolio than we have owned historically.

Our equity-focused venture capital portfolio is comprised of companies at varying maturities facing different types of risks. We have defined these levels of maturity and sources of risk as: 1) Early Stage/Technology Risk, 2) Mid Stage/Market Risk and 3) Late Stage/Execution Risk. Early-stage companies have a high degree of technical, market and execution risk, which is typical of initial investments by venture capital firms, including us. Mid-stage companies are those that have overcome most of the technical risk associated with their products and are now focused on addressing the market acceptance for their products. Late-stage companies are those that have determined there is a market for their products, and they are now focused on sales execution and scale. Late-stage, life sciences companies are typically generating revenue from the commercial sale of one or more products or, in the case of therapeutic or

medical device-focused life sciences companies, are in Phase III Clinical Trials, which are the pivotal trials before a possible FDA approval and commercial launch of a product.

Our current portfolio is comprised of BIOLOGY+ and other companies at varying stages of maturity in a diverse set of industries. As our portfolio companies mature, we seek to invest in new early- and mid-stage companies that may mature into mid- and late-stage companies. This continuous progression creates a pipeline of investment maturities that may lead to future sources of positive contributions to net asset value per share as these companies mature and potentially experience liquidity and exit events. Our pipeline of investment maturities for the 24 equity-focused companies in our portfolio that have yet to complete liquidity events (e.g., IPOs onto national exchanges or M&A transactions) and are not in the process of being shut down are shown in the figure below (our "Active Portfolio").

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

We categorized our three new portfolio companies in 2014, Accelerator IV-New York Corporation, Tara Biosystems, Inc., and UberSeq, Inc., as early-stage companies. Molecular Imprints, Inc., which we previously categorized as a late-stage company, was acquired by Canon, Inc., in the second quarter of 2014, and we have retained ownership in a new company created from the non-semiconductor manufacturing business of Molecular Imprints. We categorized the new company, which retained the name "Molecular Imprints, Inc." as a mid-stage company. During the third quarter of 2014, we transitioned SiOnyx, Inc., from a mid-stage company to an early-stage company and Cambrios Technologies Corporation from a late-stage company to a mid-stage company. During the fourth quarter of 2014, we did not transition the stage categorization of any of our portfolio companies.

**Portfolio Company Revenue**

We aggregate the revenues of our equity-focused portfolio companies on an annual basis and report these aggregated amounts for the prior three calendar years. These revenues include contributions solely from those equity-focused portfolio companies that have yet to complete liquidity events (e.g., IPOs, up-listings, or M&A transactions) and are not in the process of being shut down as of December 31, 2014. This approach enables the comparison of aggregate revenues for our portfolio as of the end of a given year with those generated by the same set of companies in prior years. As such, the total revenues in a given historical year will fluctuate owing to the change of the composition of our equity-focused portfolio companies.

We had 20 of our 24 companies in our Active Portfolio as of December 31, 2014, that generate revenues ranging from nominal to significant from commercial sales of products and/or services, from commercial partnerships and/or from government grants. The following table lists the aggregate revenues and change between years for these 20 portfolio companies in 2012, 2013 and 2014, grouped by stage of development, as of December 31, 2014, and in total.

	2014 Aggregate Revenue (\$ Million)	2013 Aggregate Revenue (\$ Million)	Change in Revenues from 2013 to 2014		2012 Aggregate Revenue (\$ Million)	Change in Revenues from 2012 to 2013	
Early Stage	\$ 4.6	\$ 3.6	28	%	\$ 7.3	-51	%
Mid Stage	\$ 28.7	\$ 29.1	-1	%	\$ 31.0	-6	%
Late Stage	\$ 239.6	\$ 217.3	10	%	\$ 131.8	65	%
Total	\$ 272.9	\$ 250.0	9	%	\$ 170.1	47	%
Combined Mid and Late Stage	\$ 268.3	\$ 246.4	9	%	\$ 162.8	51	%

The revenue amounts listed in the table above include revenues generated by our portfolio companies in the years reported, but do not include revenues from acquired businesses prior to the consummation of those transactions.

As of December 31, 2014, we had one equity-focused portfolio company, Solazyme, Inc., that is not included in the table above. Solazyme had revenues in 2014, 2013 and 2012 of \$60.4 million, \$39.8 million and \$44.1 million, respectively.

We note that the revenues of our mid-stage companies decreased from 2012 to 2013 and 2013 to 2014. This decrease is related primarily to a transition of the source of revenues from government grants and contracts to the sale of products. We believe such transitions are often positive developments for companies even if they result in short-term decreases in revenues.



***Ownership of our Portfolio Companies***

By studying our portfolio in greater detail, it is evident to us that potential returns from approximately half of the companies in our portfolio could be the real drivers of net asset value growth over the coming years. These companies include ones in which we have substantial ownership and ones where we believe the potential value at exit is substantial. The table below provides some additional detail on our ownership of the 24 equity-focused companies in our portfolio that have yet to complete liquidity events (e.g., IPOs on national exchanges or M&A transactions) and are not in the process of being shut down.

<b>Portfolio Company</b>	<b>Voting Ownership Range</b>
--------------------------	-------------------------------

EchoPixel, Inc.	
-----------------	--

ProMuc, Inc.	
--------------	--

Senova Systems, Inc.	>20%
----------------------	------

Sionyx, Inc.	
--------------	--

UberSeq, Inc.	
---------------	--

ABSMaterials, Inc.	
--------------------	--

Enumeral Biomedical Holdings, Inc.	
------------------------------------	--

HZO, Inc.	15-20%
-----------	--------

Produced Water Absorbents, Inc.	
---------------------------------	--

TARA Biosystems, Inc.	
-----------------------	--

	10-15%
--	--------

Adesto Technologies Corporation	
---------------------------------	--

Metabolon, Inc.	
-----------------	--

OpGen, Inc.	
-------------	--

Accelerator IV–New York Corporation

AgBiome, LLC 5-10%

Ensemble Therapeutics Corporation

Bridgelux, Inc.

Cambrios Technologies Corporation

Champions Oncology, Inc. 2.5-5%

Mersana Therapeutics, Inc.

Molecular Imprints, Inc.

Nantero, Inc.

D-Wave Systems, Inc. 0-2.5%

Nanosys, Inc.

In previous communications with shareholders, we have discussed how we are managing our portfolio, feeding the "fat hogs" and starving the "lean hogs" to maximize our value at exit. Many of the leaner hogs have experienced write-downs in valuation, and we have de-emphasized them in terms of the time allocation of our team. These steps allow us to focus our time and capital on the companies we believe will be the drivers of our growth. This increases the risk and potential loss of invested capital in these portfolio companies, but it also may increase the potential returns if they are successful. We currently believe companies like D-Wave Systems, Inc., Metabolon, Inc., Adesto Technologies Corporation, HZO, Inc., Produced Water Absorbents, Inc., AgBiome, LLC, Senova Systems, Inc., Enumeral Biomedical Holdings, Inc., and EchoPixel, Inc., may have the potential to be real drivers of growth in our portfolio in the coming years.

### *Level of Involvement in Our Portfolio Companies*

The 1940 Act generally requires that BDCs offer to "make available significant managerial assistance" to portfolio companies. We are actively involved with our portfolio companies through membership on boards of directors, as observers to the boards of directors and/or through frequent communication with management. As of December 31, 2014, we held at least one board seat or observer rights on 19 of our 24 equity-focused portfolio companies that have yet to complete a liquidity event or an uplisting to a national exchange and are not in the process of being shut down (79 percent).

We may hold two or more board seats in early-stage portfolio companies or those in which we have significant ownership. We may transition off of the board of directors to an observer role as our portfolio companies raise additional capital from new investors, as they mature or as they are able to attract independent members who have relevant industry experience and contacts. We also typically step off the board of directors upon the completion of or prior to the expiration of the lock-up provisions related to a public offering / listing. Our observer rights at board of directors meetings commonly cease when companies complete a public listing. We have not held a board seat or observer rights at Solazyme, Inc., since it completed its IPO in May of 2011, or an observer seat at Champions Oncology since August of 2013.

We may be involved actively in the formation and development of business strategies of our earliest stage portfolio companies. This involvement may include hiring management, licensing intellectual property, securing space and raising additional capital. We also provide managerial assistance to late-stage companies looking for potential exit opportunities by leveraging our relationships with the banking and investment community and our knowledge and experience in running a micro-capitalization publicly traded business.



## **Invest**

### ***Investment Objective and Strategy***

Our principal investment objective is to achieve long-term capital appreciation by making equity-focused venture capital investments in companies that we believe have exceptional growth potential. Therefore, a significant portion of our current venture capital investment portfolio provides little or no income in the form of dividends or interest. Current income is a secondary investment objective. We seek to reach the point where future growth is financed through reinvestment of our capital gains from our venture capital investments and where current income offsets significant portions of our annual expenses during periods of time between realizations of capital gains on our investments. We also plan to implement a strategy to grow assets under management and generate current income by raising one or more third-party funds to manage. It is possible that we will invest our capital alongside or through these funds in portfolio companies. These funds may be focused on specific sectors, such as life sciences, energy and electronics, that are enabled by scientific breakthroughs, including BIOLOGY+. There is no assurance when and if we will be able to raise such fund(s) or, if raised, whether they will be successful.

We have discretion in the investment of our capital to achieve our objectives. Our venture capital investments are made primarily in equity-related securities of companies that can range in stage from pre-revenue to generating positive cash flow. These businesses tend to be thinly capitalized, unproven, small companies that lack management depth, have little or no history of operations and are developing unproven technologies. These businesses may be privately held or publicly traded. We historically have invested in equity securities of these companies that are generally illiquid owing to restrictions on resale and to the lack of an established trading market. We refer to our portfolio of investments in equity and equity-related securities in sections of the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") as our "equity-focused" portfolio of investments. We have historically, from time to time, taken advantage of opportunities to generate near-term cash flow by investing in non-convertible debt securities of small businesses. These businesses tend to be generating cash or have near-term visibility to reaching positive cash flow. We refer to our portfolio of investments in non-convertible debt in sections of the MD&A as our "venture debt" portfolio of investments. We do not currently expect to make a significant number of venture debt investments outside of portfolio companies in which we hold equity securities.

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



We have always been involved with founding, incubating and building transformative companies from disruptive science. In fact, we have been the first institutional investor or syndicate of first institutional investors in two-thirds of the companies we have invested in since our founding. Our involvement may include hiring management, licensing intellectual property, securing space and raising additional capital. We also provide managerial assistance to late-stage companies looking for potential exit opportunities by leveraging our relationships with the banking and investment community and our knowledge and experience in running a micro-capitalization publicly traded business.

Beginning in 2008, the majority of our initial investments in privately held and early-stage publicly traded companies have been in companies that we define as BIOLOGY+.

The table below discusses how certain of our portfolio companies have teamed innovations in biology with innovations in engineering, physics, electronics, IT, mathematics and material sciences. In the case of Enumeral Biomedical Corp., this combination enables the ability to interrogate cells at the single cell scale in unique ways for the first time. In the case of TARA Biosystems, Inc., the combination enables personal diagnostics and toxicity testing by using microfabrication to create environments where heart tissue can grow in an environment that is more similar to the human body than through other techniques. This increases the speed and reduces the cost of large-scale sequencing. In the case of D-Wave Systems, Inc., its quantum computer can be used to solve very complex protein folding problems to enable new therapeutic approaches.

Currently, we plan to focus all our efforts on building new companies enabled by our BIOLOGY+ thesis. We believe areas such as 1) personalized genomics, 2) novel therapeutics for cancer, and 3) 3D non-invasive imaging and diagnostics, as well as applications in agriculture, industrial biotechnology, water, functional foods and personal health will all be influenced by innovations in BIOLOGY+.

There are very few people and very few venture capital firms still in existence that have the expertise to find, incubate and build these types of companies. The disruptive science comes from leading laboratories at premier research institutions. It takes time, experience and often partnerships with leading, global scientific companies to bring the technology to market. Our team, with scientific backgrounds in chemistry, biochemical engineering, physics, genetics and material science, is uniquely qualified to identify, diligence and invest in these opportunities.

### ***Growth in Ownership of Portfolio Companies***

The chart below depicts the change in our ownership of our portfolio companies from 2001 through 2014 as our assets have increased. Our fully diluted, investment-weighted average ownership has increased from approximately five percent for initial investments made between 2001 and 2004 to approximately 15 percent for initial investments made between 2009 and 2014. This increasing ownership, which we have noted in previous shareholder communications, gives us more control over these companies to potentially affect outcomes beneficial to the Company. Over the coming five years, as companies where our initial investment was made between 2005 and the present continue to mature and exit, we believe our increased levels of ownership have the potential to provide greater returns than our historical investments.

Our goal with our new investments is to have even greater ownership at the time of the realization of our return than we have had historically for all of the reasons discussed above.

***Investments and Current Investment Pace***

The following is a summary of our initial and follow-on equity-focused investments from January 1, 2010, to December 31, 2014. We consider a "round led" to be a round where we were the new investor or the leader of a group of investors in an investee company. Typically, but not always, the lead investor negotiates the price and terms of the deal with the investee company.

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

	2010	2011	2012	2013	2014
Total Incremental Investments	\$9,560,721	\$17,688,903	\$15,141,941	\$18,076,288	\$14,276,808
No. of New Investments	3	4	2	2	3
No. of Follow-On Investment Rounds	27	31	26	37	33
No. of Rounds Led	5	4	3	9	8
Average Dollar Amount – Initial	\$117,069	\$1,339,744	\$1,407,500	\$550,001	\$338,677
Average Dollar Amount – Follow-On	\$341,093	\$397,740	\$474,113	\$449,359	\$401,842

***Industry Sectors of Investment***

We generally classify our investments in one of three industry sectors: Life Sciences, Energy and Electronics. The interdisciplinary nature of science-based inventions enables our portfolio companies to address needs in multiple sectors rather than being confined to addressing needs in one sector. As such, many of our companies can adjust their business foci to address needs in a secondary sector should opportunities in the company's primary sector decrease in number or magnitude.

We classify companies in our life sciences portfolio as those that address problems in life sciences-related industries, including biotechnology, agriculture, advanced materials and chemicals, diagnostics, healthcare, bioprocessing, water, industrial biotechnology, food, nutrition and energy. We classify companies that address life science-related problems as a primary or secondary sector as BIOLOGY+. With our focus on investing in BIOLOGY+ companies, we expect that the number of companies addressing life science-related industries as a primary focus will grow, while those that address electronics and energy-related sectors as a primary focus will decline. That said, we expect these companies may address electronics and energy-related sectors as a secondary sector given the interdisciplinary nature of BIOLOGY+ companies.

We classify companies in our energy portfolio as those that seek to improve performance, productivity or efficiency, and to reduce environmental impact, waste, cost, energy consumption or raw materials. Energy is a term used commonly to describe products and processes that solve global problems related to resource constraints. The term "cleantech" is also used commonly in a similar manner.

We classify companies in our electronics portfolio as those that address problems in electronics-related industries, including semiconductors, telecommunications and data communications, metrology and test and measurement.

### **Importance of Availability of Liquid Capital**

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

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

We manage the company and our investment criteria and pace such that our projected needs for capital to make new and follow-on investments do not exceed the total of our liquid investments. Although we use best efforts to predict 1) when this capital will be required for use in new and follow-on investments, we cannot predict with certainty the timing for these investments. We would be unable to make new or follow-on investments in our portfolio companies without having substantial liquid resources of capital available to us.

Venture capital firms traditionally invest beside other venture capital firms in a process called syndication. The size of the fund and the amount of capital reserves available to syndicate partners is often an attribute that potential 2) co-investors consider when deciding on syndicate partners. As we do not have committed capital from limited partners, we believe we must have adequate available liquid capital on our balance sheet to be able to have access to high-quality deal flow.

3) We rarely commit the total amount of cumulative capital intended for investment in any portfolio company at one point in time. Instead, our investments consist of multiple rounds of financing of a given portfolio company, in which we typically participate if we believe that the merits of such an investment outweigh the risks. We also commonly have preemptive rights to invest additional capital in our privately held portfolio companies. These rights



are useful to protect and potentially increase the value of our positions in our portfolio companies as they mature. Commonly, the terms of such financings in privately held companies also include penalties for those investors that do not invest in these subsequent rounds of financing. Without available capital at the time of investment, our ownership in the company would be subject to these penalties that can lead to a partial or complete loss of the capital invested prior to that round of financing.

We may have the opportunity to increase ownership in late rounds of financing in some of our most mature companies. Many private venture capital funds that invested in these companies are reaching the end of the term associated with their limited partnerships. This issue may limit the available capital to these funds for follow-on investments, and the ability to take advantage of potentially valuable terms given to those who have investable capital. Having permanent, liquid capital available for investment and access to the capital markets allows us to take advantage of these opportunities as they arise.

On September 30, 2013, we secured the \$20,000,000 Loan Facility from Orix Corporate Capital, Inc. This Loan Facility replaced the \$10,000,000 facility we secured from TD Bank in February of 2011. Orix Corporate Capital is a diversified financial conglomerate with substantial assets that has extensive experience working with venture capital firms and venture capital-backed companies through its Orix Ventures unit. We believe this knowledge, combined with the quality of our portfolio companies and our investments in those companies, enabled us to obtain a credit facility secured, in part, by our portfolio of primarily privately held portfolio companies versus solely the cash security of our prior credit facility.

We believe the Loan Facility is beneficial for three primary reasons. First, we currently believe our existing portfolio of mid- and late-stage companies will generate meaningful returns in the next two-to-three years. That said, the exact timing of these realizations is uncertain. We currently believe our strong balance sheet of liquid assets (that is, cash and publicly traded securities) combined with this facility will allow us time and capital resources to realize these meaningful returns without materially compromising the rate of deployment of capital into investment opportunities that have the potential to build value for us.

Second, as we have said historically, there are a substantial number of investment opportunities in existing and new portfolio companies that we believe have the potential to build value through increasing our future returns on investment. The Loan Facility expands our financial resources for making such investments without resulting in dilution to our shareholders through the issuance of additional shares of our common stock.

Third, the Loan Facility establishes a relationship between us and Orix Corporate Capital that could be beneficial to our portfolio companies, and thus us, in the future. Many of our portfolio companies secure lines of credit and other forms of access to capital. Orix Corporate Capital has the resources and capability to address many of these needs. We believe the combination of the financial and other resources of each of our firms will be a powerful collaboration that helps to build value in our portfolio companies, and thus value for us.

### *Our Sources of Liquid Capital*

The sources of liquidity that we use to make our investments are classified as primary and secondary liquidity. As of December 31, 2014, and December 31, 2013, our total primary and secondary liquidity was \$29,620,665 and \$33,620,478, respectively. We do not include funds available from our credit facility as primary or secondary liquidity. We believe it is important to examine both our primary and secondary liquidity when assessing the strength of our balance sheet and our future investment capabilities.

Primary liquidity is comprised of cash, U.S. government securities and certain receivables. As of December 31, 2014, we held \$20,748,314 in cash, \$0 in U.S. government securities and \$230,478 in certain receivables. As of December 31, 2013, we held \$8,538,548 in cash, \$18,999,810 in U.S. government securities and \$534,826 in certain receivables.

During the year ended December 31, 2014, proceeds from several transactions added to our primary liquidity. We sold 117,834 shares of our investment in Solazyme, Inc., in open market sales. We received \$1,407,520 in net proceeds from these transactions. We also sold 575,756 shares of our investment in Champions Oncology, Inc., in open market sales. We received \$636,259 in net proceeds from these transactions. We purchased and sold call option contracts on our publicly traded positions generating net proceeds of \$119,697. On April 18, 2014, we received proceeds of \$6,486,461 from the sale of Molecular Imprints, Inc.'s semiconductor lithography equipment business to Canon, Inc. We received proceeds of \$2,374,827 from the sale of Xradia, Inc., which were released from escrow during the year. On August 1, 2014, the Company received \$549,238 in payment of the outstanding principal, interest and warrants of OHSO Clean, Inc. On November 17, 2014, the Company received \$2,070,955 upon achievement of the BLA filing milestone associated with the acquisition of BioVex Group, Inc., by Amgen, Inc. On December 18, 2014, the Company received \$48,071 from Nanosys, Inc., in payment of the principal amount plus accrued interest of a convertible promissory note. On December 24, 2014, the Company received \$79,310 of total proceeds due of \$158,621 from the sale of certain warrants of GEO Semiconductor, Inc. The remaining proceeds due of \$79,311 are included in our receivables as of December 31, 2014. Payments for additional milestones of the BioVex Group, Inc., and Molecular Imprints sales will add to our primary liquidity in future quarters if these milestones are achieved successfully. The probability-adjusted values of the future milestone payments for the sales of BioVex and Molecular Imprints, as determined at the end of each fiscal quarter, are included as an asset on our Consolidated Statements of Assets and Liabilities and will be included in primary liquidity only if and when payment is received for achievement of the milestones.

Our secondary liquidity is comprised of the stock of both unrestricted and restricted publicly traded companies. Although these companies are publicly traded, their stock may not trade at high volumes and prices may be volatile, which may restrict our ability to sell our positions at any given time. Secondary liquidity does not include the value of warrants or options we hold in Champions Oncology, Inc., or Enumeral Biomedical Holdings, Inc. As of December 31, 2014, our secondary liquidity was \$8,641,873. Solazyme, Inc., accounts for \$129,000 of the total amount of secondary liquidity based on the closing price of its common stock of \$2.58 as of December 31, 2014. Champions Oncology accounts for \$1,261,695 of the total amount of secondary liquidity based on the closing price of its common stock of \$0.50 as of December 31, 2014. Enumeral Biomedical accounts for \$7,251,178 of the total amount of

secondary liquidity based on the closing price of its common stock of \$1.05 as of December 31, 2014, less a liquidity discount to reflect that these shares are subject to restrictions on transfer. We are also subject to a lock-up agreement that restricts our ability to trade our securities of Enumeral Biomedical, exclusive of the general restriction on the transfer of unregistered securities. The lock-up period on our 7,966,368 shares of Enumeral Biomedical expires on January 31, 2016.

As of December 31, 2013, our secondary liquidity was \$5,547,294. Solazyme accounted for \$1,827,712 of the total amount of secondary liquidity based on the closing price of its common stock as of December 31, 2013. Champions Oncology accounted for \$3,719,582 of the total amount of secondary liquidity based on the closing price of its common stock as of December 31, 2013. A decision to sell our shares would result in the cash received from the sale of these assets being included in primary liquidity. Until that time, we will continue to include the value of our shares of our publicly traded portfolio companies in secondary liquidity unless the average trading volume of each company reaches sufficient levels for us to monetize our stock in such companies over a short period of time.

We also have the \$20,000,000 Loan Facility, which we can draw on to increase our available liquid capital. As of December 31, 2014, we had no outstanding debt relating to this Loan Facility.

### **Partner**

As the structure of the public markets has changed over the last decade, the time and dollars required to build transformative companies has increased. Scale and manufacturing expertise is now critical to get to a successful outcome. We believe this expertise is best accomplished by partnering with corporations at earlier stages in the development of the enterprise. Proper partnering can lead to more capital efficient businesses that provide better returns for investors.

We bring technology platforms and expertise in company building. Our corporate partners bring expertise in scale and manufacturing and access to end markets. We primarily partner with corporations as syndicate partners investing in and working with to build early-stage companies. A syndicate of financial investors besides key strategic corporations from the very first round of capital is becoming more common in our investments. Over three-fourths of our portfolio companies have significant corporate partnerships or investments, and most developed these relationships in the early-stages of development of those companies.

We are also exploring other ways to develop deep relationships with corporations and other entities that we believe will be beneficial to us and our portfolio companies including the potential for co-investment relationships.

One example of our partnership efforts comes through our investment in Accelerator IV-New York Corporation ("Accelerator IV"). Accelerator IV is a New York City-based biotechnology management company designed to leverage NYC's biotech research centers and universities to successfully invest in and develop early-stage life science technology. Accelerator IV supports emerging biotechnology innovations through its expertise, internal resources, and partner network. Its efforts are focused on the evolving healthcare and medical landscapes. Through a strategic partnership and collaboration, it uses this platform to specifically identify, evaluate, finance, and manage the commercialization of technologies and assets sourced from a broad range of proprietary sources. Other investors in Accelerator IV include Alexandria Real Estate Equities, Eli Lilly and Company, Johnson & Johnson Development Corporation and Pfizer Venture Investments. There is no assurance that we will be successful in securing other partnerships.

We have a long history working with U.S. universities to commercialize technologies discovered in their labs. We expect these relationships to become deeper as we focus on building companies developed from research from a select set of these universities going forward.

## **Return**

Our plan for returning value to shareholders has three steps. Step one of our return plan was implemented over the past six years. It includes investing in early-stage companies where we believe we can own greater than 10 percent of the company at exit with invested capital of between \$5 million and \$10 million in each company.

Step two is our focus on BIOLOGY+. Our best investment returns over the past 10 years have come from companies that have businesses intersecting with the life sciences. We are now focusing our efforts on BIOLOGY+, as we believe the future returns for companies commercializing technologies that sell into the life science markets will be greater than those focused on other markets we have invested in historically. Since 2008, approximately 84 percent of our new initial investments have been in companies that fit our BIOLOGY+ investment thesis. This percentage will increase over the coming years. That said, we note that past performance may not be indicative of future performance.

Step three is our partnering efforts. We continue to pursue strategies to increase the return profile of early-stage investing, and to reduce the cost profile so that it shifts to a profile more representative of the venture capital industry of 15 to 20 years ago. We believe this will require an environment for doing early-stage investing that includes working with corporate partners earlier in the development of these companies to 1) ascertain if there is demand for the company's technology/products and 2) to help these start-ups prepare for scale and manufacturing in a way that permits seamless adoption by industry and the consumer. This is the basis of our partnership strategy.

We believe that execution of these three steps will generate returns for shareholders over the coming years. We are focused on increasing value for shareholders through growing net asset value per share, and we believe we may have an opportunity to reduce the number of shares outstanding and provide deemed dividends as well as cash dividends as we execute on this strategy.

### **Current Business Environment**

The fourth quarter of 2014 ended with increases in value in the public market indices. These increases coincided with an increase in the number of IPOs and an increase in M&A transactions. That said, fundraising by venture capital firms continued to be challenging and concentrated to a small number of funds. These dynamics continue to lead to a difficult fundraising environment for venture-backed companies, particularly those in the middle stages of development and those focused on sectors in which we invest.

Twenty-seven venture-backed companies raised \$4.4 billion through IPOs in the fourth quarter of 2014, which marks the seventh consecutive quarter to have 20+ venture-backed IPOs, according to Thomson Reuters and the National Venture Capital Association ("NVCA"). Twenty-three of the twenty-seven were U.S.-based companies. During the year 2014, 115 venture-backed companies went public raising \$15.3 billion, which reflects a 38 percent increase from the year 2013. For the fourth quarter of 2014, 95 venture-backed M&A transactions were reported, with a total of 455 venture-backed M&A transactions for the full year. This is an increase from 377 reported acquisitions in 2013.

Seventy-five U.S. venture capital funds raised \$5.6 billion in the fourth quarter of 2014, according to Thomson Reuters and the NVCA. Compared with the third quarter of 2014, this is a 14 percent increase in the number of funds raised, but a 9 percent decrease the amount of capital raised. Venture firms raised \$16.7 billion from 185 funds in 2013. The amount raised through 2014 totaled \$29.8 billion, which represents a 69 percent increase from the amount raised in 2013 (\$17.7 billion) and an increase in the number of funds (207 in 2013). Of the 75 funds that were raised, 27 were new funds. For the year, 96 new venture capital funds raised \$3 billion, which represents 50 percent more funds and 76 percent more dollars raised than in 2013.



Historically, difficult venture environments have resulted in a higher than normal number of companies not receiving financing and being subsequently closed down with a loss to venture investors, and other companies receiving financing but at significantly lower valuations than the preceding financing rounds. This issue is compounded by the fact that many existing venture capital firms with which we have co-invested historically in a number of our current portfolio companies have few remaining years of investment and available capital owing to the finite lifetime of the funds managed by these firms. Additionally, even if a firm were able to raise a new fund, commonly venture capital firms are not permitted to invest new funds in existing investments. This limitation of available capital can lead to fractured syndicates of investors. A fractured syndicate can result in a portfolio company being unable to raise additional capital to fund operations; this issue is especially acute in capital-intensive sectors that are enabled by science-related innovations, such as life sciences, energy and electronics, which are generally not in favor among venture capital firms. The result of these difficulties is that the portfolio company may be forced to sell before reaching its full potential or be shut down entirely if the remaining investors cannot financially support the company. As such, improvements in the exit environment for venture-backed companies through IPOs and M&A transactions may not translate to an increase in the available capital to venture-backed companies, particularly those that have investments from funds that are in the latter stage of life unless the markets improve for some time into the future.

Our overall goal remains unchanged. We want to maintain our leadership position in investing in science-enabled and BIOLOGY+ companies and increase our net asset value per share outstanding. The current environment for venture capital financings continues to favor those firms that have capital to invest regardless of the stage of the investee company. We continue to finance our new and follow-on equity and convertible debt investments from our cash reserves held in bank accounts. We may in the future invest borrowed capital to take advantage of opportunities that we believe will return greater than the cost of such borrowed capital. We have historically held, and may in the future again hold, our cash in U.S. Treasury securities. We believe the current status of the venture capital industry and the current economic climate provide opportunities to invest this capital at historically low valuations and under favorable terms in equity and convertible debt of new and existing privately held and publicly traded companies.

## **Valuation of Investments**

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

The values of privately held, venture capital-backed companies are inherently more difficult to determine than those of publicly traded companies at any single point in time because securities of these types of companies are not actively traded. We believe, perhaps even more than in the past, that illiquidity, and the perception of illiquidity, can affect value. Management believes further that the long-term effects of the difficult venture capital market and difficult exit environments will continue to affect negatively the fundraising ability of weak companies regardless of near-term improvements in the overall global economy and public markets and that these factors can also affect value.



We note that while the valuations of our privately held, venture capital-backed companies may decrease, sometimes substantially, such decrease may facilitate an increase in our ownership of the overall company in conjunction with a follow-on investment in such company. In these cases, the ultimate return on our overall invested capital could be greater than it would have been without such interim decrease in valuation.

Effective September 30, 2014, the Company refined its valuation methodologies to include the option pricing model. While the Company's valuation procedures had always included the option pricing model as a possible valuation technique, it had not previously been utilized. The use of the option pricing model is emerging as a preferred industry practice. This change in valuation methodology is applied on a prospective basis.

Option pricing models use call option theory to derive the value of sets of classes of securities taking into account the financial rights and preferences of classes of securities such as liquidation preference, redemption rights and dividends. This method treats common and preferred stock as call options on the company's enterprise value. It derives breakpoints based on liquidation preferences of the preferred stock and then calculates the values of those liquidation preferences and the company as a whole using Black-Scholes-Merton equations. The sum of these values yields the estimated enterprise value of the portfolio company. This method of derivation is often referred to as "backsolve" as it uses the price per share of the most recent round of financing to backsolve for the values of the other classes of outstanding securities of the company.

Option pricing models use the following inputs in their calculations:

- Last Round Price per Share

• Liquidation Preferences (including dividends and redemptions, if any)

• Estimated Time to Exit

• Estimated Volatility

• Risk-Free Interest Rate

• Outstanding Capitalization of the Company

Variations in these inputs and assumptions can have a significant impact on fair value. Companies that are valued using market comparables and/or volatilities derived from publicly traded securities are subject to the volatilities within those markets.

Given the consideration of the liquidation preferences, option pricing models more accurately represent scenarios where liquidation preferences are honored, as they would be in an M&A scenario, but not in public offering scenarios where it is common to have all classes of preferred stock converted to common stock. Liquidation preferences are business terms that are common in the venture capital industry and are generally used to provide some downside protection should the company not meet expectations. They can be structured on parity with prior rounds of financing or senior to prior rounds of financing. They can include multiples on the amounts invested and can provide for further distributions following the initial preference or be restricted to the amount of invested capital.

This high weighting of liquidation preferences means that small differences in how the preferences are structured can have a material effect on the fair value of our securities at the time of valuation and also on future valuations should additional rounds of financing occur with senior preferences. As such, valuations calculated by option pricing models may not increase if 1) rounds of financing occur at higher prices per share, 2) liquidation preferences include multiples on investment, 3) the amount of invested capital is small and/or 4) liquidation preferences are senior to prior rounds of financing.

We note that the ultimate return on any investment may be materially different than the fair value derived as of the date of valuation.

In each of the years in the period of 2010 through 2014, excluding our rights to milestone payments, we recorded the following gross write-ups in privately held securities as a percentage of net assets at the beginning of the year ("BOY"), gross write-downs in privately held securities as a percentage of net assets at the beginning of the year, and change in value of private portfolio securities as a percentage of net assets at the beginning of the year.

#### Gross Write-Ups and Write-Downs of the Privately Held Portfolio

	2010	2011	2012	2013
Net Asset Value, BOY	\$ 134,158,258	\$ 146,853,912	\$ 145,698,407	\$ 128,4
Gross Write-Downs During Year	\$(11,391,367 )	\$(11,375,661 )	\$(19,604,046 )	\$(19,0
Gross Write-Ups During Year	\$30,051,847	\$ 11,997,991	\$ 14,099,904	\$ 10,21
Gross Write-Downs as a Percentage of Net Asset Value, BOY	(8.5 )%	(7.8 )%	(13.5 )%	(14.9
Gross Write-Ups as a Percentage of Net Asset Value, BOY	22.4 %	8.2 %	9.7 %	8.0
Net Change as a Percentage of Net Asset Value, BOY	13.9 %	0.4 %	(3.8 )%	(6.9

From December 31, 2013, to December 31, 2014, the value of our equity-focused venture capital portfolio, including our rights to potential future milestone payments from the sales of BioVex Group, Inc., Nextreme Thermal Solutions, Inc., and Molecular Imprints, Inc., decreased by \$3,021,400, from \$92,313,445 to \$89,292,045.

Not including our rights to potential future milestone payments from the sale of BioVex Group, Inc., Nextreme Thermal Solutions, Inc., and Molecular Imprints, Inc., our equity-focused portfolio companies decreased in value by \$2,725,832. This decrease was primarily owing to a net decrease in valuations, offset by new and follow-on investments of \$14,276,808.

We note that our Valuation Committee and ultimately our Board of Directors take into account multiple sources of quantitative and qualitative inputs to determine the value of our privately held portfolio companies.

We also note that our Valuation Committee does not set the value of Solazyme, Inc., our freely tradable publicly traded portfolio company, or the value of our unrestricted or registered shares of Champions Oncology, Inc., and Enumeral Biomedical Holdings, Inc., which trade on an OTC exchange.

Four portfolio companies, SiOnyx, Inc., Cambrios Technologies Corporation, HZO, Inc., and Ensemble Therapeutics Corporation, which were fair valued by our Valuation Committee, accounted for \$11.6 million, or 82 percent, of the gross write-downs of our portfolio companies still held at December 31, 2014. The contributing factors to the decreases in valuations for all but HZO were related to fundamental changes in the state of those businesses. The change in valuation of HZO was owing primarily to the terms of its Series II round of financing, that although was completed at a higher price per share than the prior round of financing, it included liquidation preferences and a conversion of a prior class of preferred stock owned by us to common stock. This new capital structure, combined with the option pricing model, are the primary sources of the decrease in the value of our securities of HZO by \$2.5 million net of additional investment by us of \$2.2 million during 2014.

Three portfolio companies, Enumeral Biomedical Holdings, Inc., D-Wave Systems, Inc., and Produced Water Absorbents, Inc., which were fair valued by our Valuation Committee, accounted for \$7.1 million, or 82 percent, of the gross write-ups of our portfolio companies still held at December 31, 2014. We note that a portion of our securities of Enumeral Biomedical Holdings were not fair valued by the Valuation Committee as of December 31, 2014, because those securities traded in an active market and were, therefore, valued based on the closing price of the shares on the date of valuation. The increase in value of Enumeral Biomedical Holdings resulted primarily from its transition from a privately held company to a publicly traded company. The increase in value of D-Wave Systems resulted primarily from the terms of a new round of financing completed in June and December 2014. The increase in value of Produced Water Absorbents resulted primarily from its substantial revenues generated through its acquisition of ProSep, Inc.

As of December 31, 2014, our top ten investments by value accounted for approximately 82 percent of the value of our equity-focused venture capital portfolio.



**Top Ten Equity-Focused Investments by Value**

<b><u>Portfolio Company</u></b>	<b><u>Value as of</u></b>	<b><u>Cumulative % of Equity Focused</u></b>
	<b><u>12/31/2014</u></b>	<b><u>Venture Capital Portfolio</u></b>
Adesto Technologies Corp.	\$14,823,323	17%
Metabolon, Inc.	\$10,696,559	29%
Enumeral Biomedical Holdings, Inc. *	\$8,384,641	39%
D-Wave Systems, Inc.	\$8,335,254	49%
Produced Water Absorbents, Inc.	\$7,277,602	58%
HZO, Inc.	\$6,917,931	66%
Nanosys, Inc.	\$4,306,042	71%
Bridgelux, Inc.	\$3,591,076	75%
Nantero, Inc.	\$3,433,338	79%
AgBiome, LLC	\$2,989,704	82%

\* Enumeral Biomedical Holdings #3 rank by value includes the value of its Level 1 asset shares.

**Results of Operations**

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

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

Net Realized Gain (Loss) on Investments - the difference between the net proceeds of sales of portfolio securities and their stated cost.

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 and monetization of our venture capital investments. We have relied, and continue to rely, primarily on proceeds from sales of investments, rather than on investment income, to defray a significant portion of our operating expenses. Because such sales are unpredictable, we attempt to maintain adequate working capital to provide for fiscal periods when there are no such sales.

The potential for, or occurrence of, inflation could result in rising interest rates for government-backed debt. We may also invest in both short- and long-term U.S. government and agency securities. To the extent that we invest in short- and long-term U.S. government and agency securities, changes in interest rates result in changes in the value of these obligations that result in an increase or decrease of our net asset value. The level of interest rate risk exposure at any given point in time depends on the market environment, the expectations of future price and market movements, and the quantity and duration of long-term U.S. government and agency securities held by the Company, and it will vary from period to period. During the year ended December 31, 2014, and December 31, 2013, our average holdings of U.S. government securities were \$2,999,955 and \$18,353,323, respectively.

### *Comparison of Years Ended December 31, 2014, 2013, and 2012*

During the years ended December 31, 2014, December 31, 2013, and December 31, 2012, we had net decreases in net assets resulting from operations of \$13,570,420, \$7,788,958 and \$19,986,900, respectively.

### Investment Income and Expenses:

During the years ended December 31, 2014, 2013, and 2012, we had net operating losses of \$7,901,727, \$8,022,206 and \$8,803,343, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expense included in salaries, benefits and stock-based compensation of \$857,006 in 2014, \$1,249,756 in 2013 and \$2,928,943 in 2012. During the years ended December 31, 2014, 2013, and 2012, total investment income was \$517,800, \$470,902 and \$722,227, respectively. During the years ended December 31, 2014, 2013, and 2012, total operating expenses were \$8,419,527, \$8,493,108 and \$9,525,570, respectively.

During the year ended December 31, 2014, as compared with the year ended December 31, 2013, investment income increased primarily owing to increases in interest income from convertible bridge notes, interest income from a non-convertible promissory note, income from yield-enhancing fees on debt securities and fees for providing managerial assistance to one of our portfolio companies, offset by a write-off of \$77,268 of previously accrued bridge note interest, a decrease in interest income from subordinated and senior secured debt and senior secured debt through a participation agreement, rental income from the sublet of our office space at 420 Florence Street, Palo Alto, CA, owing to the expiration of the lease in 2013, and a decrease in our average holdings of U.S. government securities. During the year ended December 31, 2014, our average holdings of U.S. government securities were \$2,999,955 as compared with \$18,353,323 during the year ended December 31, 2013, primarily owing to the decrease in yield available over the durations of maturities in which we were willing to invest.

Operating expenses, including non-cash, stock-based compensation expenses, were \$8,419,527 and \$8,493,108 for the year ended December 31, 2014, and December 31, 2013, respectively. The decrease in operating expenses for the year ended December 31, 2014, as compared with the year ended December 31, 2013, was primarily owing to decreases in salaries, benefits and stock-based compensation expense, rent expense and insurance expense, offset by increases in administration and operations expense, professional fees, interest and other debt expense, directors' fees and expenses and custody fees.

Salaries, benefits and stock-based compensation expense decreased by \$482,956, or 9.0 percent, for the year ended December 31, 2014, as compared with December 31, 2013, primarily as a result of decreases in compensation cost for restricted stock awards associated with the Stock Plan owing to a reversal of compensation expense of \$256,334 for stock awards that were forfeited as a result of the voluntary termination of one of our employees on June 30, 2014, and the voluntary termination of two of our employees on December 31, 2014, a decrease in employee bonus expense of \$165,500, and a decrease in salary and benefits owing to the aforementioned voluntary termination of one of our employees on June 30, 2014, net of increases in costs associated with the salary and benefits for one of our employees whose status changed from a part-time employee in 2013 to a full-time employee in 2014 and the hiring of a new full-time employee effective August 18, 2014. While the non-cash, stock-based compensation expense for the Stock Plan increased our operating expenses by \$857,006, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our net asset value. Rent expense decreased by \$77,312, or 20.5 percent, for the year ended December 31, 2014, as compared with December 31, 2013, owing primarily to the expiration of the lease for our office space at 420 Florence Street, Palo Alto, CA, on August 30, 2013. Our rent expense of \$299,048 for the year ended December 31, 2014, includes \$321,145 of rent paid in cash, net of \$22,097 non-cash rent expense, credits and abatements that we recognize on a straight-line basis over the lease term. Our rent paid in cash of \$321,145 includes \$24,565 of real estate tax escalation charges on our corporate headquarters located at 1450 Broadway in New York City. Insurance expense decreased by \$55,832, or 14.8 percent, for the year ended December 31, 2014, as compared with December 31, 2013, primarily as a result of a decrease in overall annual renewal premiums.

Administration and operations expense increased by \$24,681, or 3.8 percent, for the year ended December 31, 2014, as compared with December 31, 2013, primarily as a result of net increases in general office and administration expenses, including costs of \$31,235 associated with a Meet the Portfolio Day event, offset by decreases in managing directors' travel-related expenses. We did not hold a Meet the Portfolio Day during the comparable period in 2013. Professional fees increased by \$128,920, or 10.3 percent, for the year ended December 31, 2014, as compared with December 31, 2013, primarily as a result of an increase in certain accounting fees and consulting fees associated with investor outreach and marketing efforts, offset by a decrease in certain legal fees. Interest and other debt expense increased by \$261,237, or 224.4 percent, for the year ended December 31, 2014, as compared with December 31, 2013, primarily as a result of non-utilization fees and amortization of closing fees associated with our Loan Facility. Directors' fees and expenses increased by \$127,826, or 52.0 percent, for the year ended December 31, 2014, as compared with December 31, 2013, primarily owing to an increase in overall fees and the addition of a new member to our Board of Directors in 2014. Custody fees increased by \$1,612, or 2.8 percent, for the year ended December 31, 2014, as compared with December 31, 2013.

During 2013, as compared with 2012, investment income decreased from \$722,227 to \$470,902, reflecting a net decrease in interest income from convertible bridge notes, non-convertible promissory notes, subordinated and senior secured debt. During the year ended December 31, 2013, we accrued net bridge note interest of \$67,781, as compared with \$235,806 during the year ended December 31, 2012. During the year ended December 31, 2013, our average holdings of U.S. government securities were \$18,353,323 as compared with \$3,884,228 during the year ended December 31, 2012, primarily owing to reinvestment of the proceeds received from the sales of Xradia, Inc., and shares of Solazyme, Inc. The average yield on our U.S. government securities for the year ended December 31, 2013, and 2012, was 0.03 and 0.10 percent, respectively.

Operating expenses, including non-cash, stock-based compensation expenses, were \$8,493,108 and \$9,525,570 for the year ended December 31, 2013, and December 31, 2012, respectively. The decrease in operating expenses for the year ended December 31, 2013, as compared with the year ended December 31, 2012, was primarily owing to decreases in salaries, benefits and stock-based compensation expense, administration and operations expense, rent expense and directors' fees and expenses, offset by increases in professional fees, interest and other debt expense and custody fees. Salaries, benefits and stock-based compensation expense decreased by \$1,230,042, or 18.7 percent, for the year ended December 31, 2013, as compared with December 31, 2012, primarily as a result of a decrease in non-cash stock-based compensation expense of \$1,679,187 associated with the Stock Plan and a decrease of \$406,780 in the projected benefit obligation expense accrual for medical and pension retirement benefits, offset by increases in bonus accruals and salaries of employees owing to cost of living adjustments and costs associated with increases in salary for three of our employees who were promoted in 2013 from their positions in 2012. While the non-cash, stock-based compensation expense for the Stock Plan increased our operating expenses by \$1,249,756, this increase was offset by a corresponding increase to our additional paid-in capital, resulting in no net impact to our net asset value. Administration and operations expense decreased by \$47,159, or 4.4 percent, for the year ended December 31, 2013, as compared with December 31, 2012, primarily as a result of decreases in costs associated with investor outreach expenses, general office and administration expenses, and timing differences related to certain accrued expenses, offset by increases in managing directors' travel-related expenses. We did not hold a Meet the Portfolio Day during the year ended December 31, 2013, as compared with costs of approximately \$37,668 associated with such an event in the comparable period in 2012. Rent expense decreased by \$32,299, or 7.9 percent, for the year ended December 31, 2013, as compared with December 31, 2012. Our rent expense of \$376,360 for the year ended December 31, 2013, includes \$392,335 of rent paid in cash, net of \$15,975 non-cash rent expense, credits and abatements that we recognize on a straight-line basis over the lease term. Our rent paid in cash of \$392,335 includes \$13,924 of real estate tax escalation charges on our corporate headquarters located at 1450 Broadway in New York City. Directors' fees and expenses decreased by \$50,907, or 17.2 percent, for the year ended December 31, 2013, as compared with December 31, 2012, primarily owing to a smaller Board of Directors in 2013.

Professional fees increased by \$254,024, or 25.4 percent, for the year ended December 31, 2013, as compared with December 31, 2012, primarily as a result of an increase in certain legal fees related to establishing our Loan Facility, offset by a decrease in consulting and accounting fees. Interest and other debt expense increased by \$68,295, or 141.9 percent, for the year ended December 31, 2013, as compared with December 31, 2012, primarily as a result of non-utilization fees associated with our Loan Facility with Orix Corporate Capital, Inc. Custody fees increased by \$9,109, or 18.5 percent, for the year ended December 31, 2013, as compared with December 31, 2012.



Realized Gains and Losses from Investments:

During the years ended December 31, 2014, 2013, and 2012, we realized net (losses) gains on investments of \$(5,083,625), \$18,516,268 and \$2,406,433, respectively. For the years ended December 31, 2014, 2013, and 2012, we realized net (losses) gains from investments, before taxes, of \$(5,065,729), \$18,544,262 and \$2,421,669, respectively. Income tax expense for the years ended December 31, 2014, 2013 and 2012 was \$17,896, \$27,994 and \$15,236, respectively.

During the year ended December 31, 2014, we realized net losses of \$5,065,729, consisting primarily of realized losses on the value of our investments in Kovio, Inc., of \$7,299,533, and Contour Energy Systems, Inc., of \$4,488,576, offset by a realized gain of \$3,947,151 on the sale of our investment in Molecular Imprints, Inc., a realized gain of \$16,000 on the early repayment of the senior secured debt by OHSO Clean, Inc., a realized gain of \$68,371 on the sale of certain warrants of GEO Semiconductor, Inc., a realized gain of \$204,442 on the sale of 575,756 shares of Champions Oncology, Inc., a realized gain of \$1,129,054 on the sale of 117,834 shares of Solazyme, Inc., and a realized gain of \$232,079 on the repurchase and expiration of certain Solazyme written call option contracts. At December 31, 2014, we still owned 2,523,895 and 50,000 shares of Champions Oncology and Solazyme, respectively. We also had a realized gain of \$588,440 on our escrow payment from the sale of Xradia, Inc., and a realized gain of \$536,813 on our investment in rights to milestone payments from Amgen, Inc.

During the year ended December 31, 2013, we realized net gains of \$18,544,262, consisting primarily of a net realized gain on our investment in Xradia, Inc., of \$10,624,634, a realized gain of \$12,570,595 on the sale of 1,629,956 shares of Solazyme, Inc., of which 884,800 shares were called subject to the terms of written call option contracts, a realized gain of \$148,729 on our escrow payment from the sale of Crystal IS, Inc., a realized gain of \$105,313 on the early repayments of the senior secured and subordinated secured debt by GEO Semiconductor, Inc., and a realized gain of \$92,529 on the sale of 193,539 shares of Champions Oncology, Inc., offset by a realized loss on the value of our investment in Nextreme Thermal Solutions, Inc., of \$4,384,762, a realized loss of \$540,106 on the sale of 50,807 shares of NeoPhotonics Corporation, of which 50,800 shares were called subject to the terms of written call option contracts, a realized loss of \$282 on the repurchase and expiration of certain Solazyme and NeoPhotonics written call option contracts, and a realized loss of \$72,209 on the expiration of certain Solazyme purchased put option contracts. At December 31, 2013, we still owned 3,099,651 and 167,834 shares of Champions Oncology and Solazyme, respectively. At December 31, 2013, we did not hold any shares of NeoPhotonics.

During the year ended December 31, 2012, we realized net gains of \$2,421,669, consisting primarily of a realized gain of \$4,101,673 on the sale of 506,359 shares of Solazyme, Inc., including the sale of 324,000 shares that were called subject to the terms of call option contracts and a realized gain of \$1,605,907 on the repurchase and expiration of certain Solazyme and NeoPhotonics Corporation written call option contracts, offset by a realized loss of \$4,307,592 on the sale of 400,100 shares of NeoPhotonics that were called subject to the terms of call option contracts. At December 31, 2012, we still owned 1,797,790 shares of Solazyme and 50,807 shares of NeoPhotonics. We had a realized gain of \$464,485 on our escrow payment from the sale of Innovalight, Inc., in 2011. We also had realized gains on our escrow payments from the sales of BioVex Group, Inc., and Crystal IS, Inc.



Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the year ended December 31, 2014, net unrealized depreciation on total investments increased by \$585,068.

During the year ended December 31, 2013, net unrealized depreciation on total investments increased by \$18,283,020.

During the year ended December 31, 2012, net unrealized depreciation on total investments increased by \$13,589,990.

During the year ended December 31, 2014, net unrealized depreciation on our venture capital investments increased by \$576,141, from net unrealized depreciation of \$22,030,334 at December 31, 2013, to net unrealized depreciation of \$22,606,475 at December 31, 2014, owing primarily to a net increase in unrealized depreciation of \$3,872,348 on our investment in Molecular Imprints, Inc., resulting from a realized gain on the sale of its securities, offset by a net decrease in unrealized depreciation on our investment in Contour Energy Systems, Inc., of \$4,419,151 resulting in a realized loss on this investment owing to its liquidation and dissolution, and Kovio, Inc., of \$7,299,533 resulting in a realized loss on this investment when such securities were deemed worthless. We also had the following write-downs in the valuations of the following portfolio company investments:

Investment	Amount of Write-Down
SiOnyx, Inc.	4,993,851
Cambrios Technologies Corporation	2,868,013
HzO, Inc.	2,515,023
Champions Oncology, Inc.	2,042,182
Ensemble Therapeutics Corporation	1,218,444
Cobalt Technologies, Inc.	901,558
Senova Systems, Inc.	359,776
Ultora, Inc.	352,388
Mersana Therapeutics, Inc.	219,770
Laser Light Engines, Inc.	195,806
ABSMaterials, Inc.	179,986
Accelerator IV – New York Corporation	164,385
OhSo Clean, Inc.	44,043
AgBiome, LLC	32,036
NanoTerra, Inc.	29,112
GEO Semiconductor, Inc.	17,708
Metabolon, Inc.	2,645





The write-downs for the year ended December 31, 2014, were offset by write-ups in the valuations of the following portfolio company investments:

Investment	Amount of Write-Up
Enumeral Biomedical Corp.	3,937,669
D-Wave Systems, Inc.	2,448,031
Produced Water Absorbents, Inc.	1,491,898
Nantero, Inc.	399,158
Bridgelux, Inc.	390,435
Nanosys, Inc.	224,040
SynGlyco, Inc.	152,662
Adesto Technologies Corporation	121,875
OpGen, Inc.	80,191
EchoPixel, Inc.	62,425
UberSeq, Inc.	6,159

We had an increase in unrealized depreciation of \$1,420,247 on our investment in Solazyme, Inc., primarily owing to realized gains on the partial sale of the securities.

We had an increase in unrealized depreciation owing to foreign currency translation of \$788,951 on our investment in D-Wave Systems, Inc.

We had an increase in unrealized depreciation of \$722 on the rights to milestone payments from Canon, Inc.'s acquisition of Molecular Imprints, Inc.

We had a decrease in unrealized depreciation of \$609,626 on the rights to milestone payments from Amgen, Inc.'s acquisition of BioVex Group, Inc.

Unrealized appreciation on our U.S. government securities portfolio decreased from unrealized appreciation of \$45 at December 31, 2013, to \$0 at December 31, 2014. We did not hold any U.S. government securities at December 31, 2014.

During the year ended December 31, 2013, net unrealized depreciation on our venture capital investments increased by \$18,281,703, from net unrealized depreciation of \$3,748,631 at December 31, 2012, to net unrealized depreciation

of \$22,030,334 at December 31, 2013, owing primarily to a decrease in unrealized appreciation of \$8,303,684 on our investment in Xradia, Inc., resulting from realized gains on the sale of its securities and a decrease in unrealized appreciation of \$8,451,603 on our investment in Solazyme, Inc., resulting from realized gains on the partial sale of its securities. We also had write-downs in the valuations of the following portfolio company investments:

Investment	Amount of Write-Down
SiOnyx, Inc.	4,014,690
Contour Energy Systems, Inc.	3,746,352
OpGen, Inc.	3,260,000
Laser Light Engines, Inc.	2,259,495
Kovio, Inc.	1,771,912
Enumeral Biomedical Corp.	1,443,004
Ultora, Inc.	885,042
SynGlyco, Inc.	655,935
Cobalt Technologies, Inc.	295,132
Senova Systems, Inc.	292,887
GEO Semiconductor, Inc.	65,507
Produced Water Absorbents, Inc.	28,170
D-Wave Systems, Inc.	177

The write-downs for the year ended December 31, 2013, were offset by write-ups in the valuations of the following portfolio company investments:

Investment	Amount of Write-Up
Metabolon, Inc.	3,376,119
Champions Oncology, Inc.	2,340,011
Ensemble Therapeutics Corporation	1,429,780
Molecular Imprints, Inc.	1,317,999
HzO, Inc.	1,225,523
Bridgelux, Inc.	865,062
Cambrios Technologies Corporation	854,586
AgBiome, LLC	500,000
ABSMaterials, Inc.	384,017
Nanosys, Inc.	178,329
Adesto Technologies Corporation	34,542
OhSo Clean, Inc.	33,302
NanoTerra, Inc.	19,735

We had an increase in unrealized appreciation of \$4,384,762 on our investment in Nextreme Thermal Solutions, Inc., owing to a realized loss on the sale of its securities.

We had an increase in unrealized appreciation of \$88,699 on the rights to milestone payments from Amgen, Inc.'s acquisition of BioVex Group, Inc.

We had a decrease in unrealized appreciation of \$371,513 on our investment in D-Wave Systems, Inc., owing to foreign currency translation.

We had an increase in unrealized appreciation of \$530,934 on our investment in NeoPhotonics Corporation owing to realized losses on the sale of its securities.

Unrealized appreciation on our U.S. government securities portfolio decreased from unrealized appreciation of \$2,744 at December 31, 2012, to \$45 at December 31, 2013.

During the year ended December 31, 2012, net unrealized appreciation on our venture capital investments decreased by \$13,480,234, from net unrealized appreciation of \$9,731,603 at December 31, 2011, to net unrealized depreciation of \$3,748,631 at December 31, 2012, owing primarily to decreases in the valuations of the following portfolio company investments:

Investment	Amount of Write-Down
Solazyme, Inc.	6,524,259
Bridgelux, Inc.	6,121,656
Ancora Pharmaceuticals Inc.	4,330,723
Kovio, Inc.	1,721,913
Mersana Therapeutics, Inc.	1,524,629
ABSMaterials, Inc.	1,434,082
Contour Energy Systems, Inc.	1,279,064
Laser Light Engines, Inc.	1,172,892
HzO, Inc.	732,651
Produced Water Absorbents, Inc.	721,830
Champions Oncology, Inc.	625,107
Senova Systems, Inc.	441,363
Cambrios Technologies Corporation	54,040
SiOnyx, Inc.	50,342
NanoTerra, Inc.	18,861

The write-downs for the year ended December 31, 2012, were offset by write-ups in the valuations of the following portfolio company investments:

Investment	Amount of Write-Up
Xradia, Inc.	5,324,907
Nanosys, Inc.	2,453,186
Adesto Technologies Corporation	2,393,372
Nantero, Inc.	1,210,298
Ensemble Therapeutics Corporation	1,077,795

Cobalt Technologies, Inc.	823,029
NeoPhotonics Corporation	563,061
D-Wave Systems, Inc.	450,972
Enumeral Biomedical Corp.	215,342
GEO Semiconductor, Inc.	16,335
OHSO Clean, Inc.	10,742
Metabolon, Inc.	22

We had an increase in unrealized appreciation of \$37,943 on the rights to milestone payments from Amgen, Inc.'s acquisition of BioVex Group, Inc.

We had an increase in unrealized appreciation owing to foreign currency translation of \$123,904 on our investment in D-Wave Systems, Inc.

We had an increase in unrealized appreciation of \$4,141,035 on our investment in NeoPhotonics Corporation owing to realized losses on the sale of its securities.

We had a decrease in unrealized appreciation of \$5,568,765 on our investment in Solazyme, Inc., owing to realized gains on the sale of its securities.

Unrealized appreciation on our U.S. government securities portfolio increased from unrealized appreciation of \$0 at December 31, 2011, to \$2,744 at December 31, 2012.

## **Financial Condition**

### *December 31, 2014*

At December 31, 2014, our total assets and net assets were \$112,094,861 and \$109,654,427, respectively. At December 31, 2013, they were \$125,063,946 and \$122,701,575, respectively.

At December 31, 2014, our net asset value per share was \$3.51, as compared with \$3.93 at December 31, 2013. At December 31, 2014, and December 31, 2013, our shares outstanding were 31,280,843 and 31,197,438, respectively.

Significant developments in the year ended December 31, 2014, included a decrease in the holdings of our venture capital investments of \$4,134,619 and a decrease in our cash and treasury holdings of \$6,790,044. The decrease in the value of our venture capital investments from \$93,899,459 at December 31, 2013, to \$89,764,840 at December 31, 2014, resulted primarily from a net decrease of \$2,043,780 owing to the sale of certain of our shares of Solazyme, Inc., and Champions Oncology, Inc., and a decrease in the net value of our venture capital investments of



\$16,367,647, offset by new and follow-on investments of \$14,276,808. The decrease in our cash and treasury holdings from \$27,538,358 at December 31, 2013, to \$20,748,314 at December 31, 2014, is primarily owing to new and follow-on venture capital investments totaling \$14,276,808 and to the payment of cash for operating expenses of \$7,547,034, offset by net proceeds of \$2,043,780 received from the sale of certain of our shares of Solazyme and Champions Oncology, net premium proceeds of \$119,697 received from certain Solazyme written call options, \$2,374,827 received from the portion of our payment held in escrow from the sale of Xradia, Inc., \$6,486,461 received from the sale of Molecular Imprints, Inc., \$2,070,955 received from our rights to milestone payments from Amgen, Inc., associated with the sale of BioVex Group, Inc., \$549,238 received from the repayment of the senior secured debt of OHSO Clean, Inc., \$48,071 from the payment of the principal amount plus accrued interest of a convertible promissory note invested in Nanosys, Inc., and \$79,310 received from the sale of certain warrants held in GEO Semiconductor, Inc.

The following table is a summary of additions to our portfolio of venture capital investments made during the year ended December 31, 2014:

New Investments	Amount of Investment
UberSeq, Inc.	\$ 500,000
TARA Biosystems, Inc.	300,020
Accelerator IV-New York Corporation	216,012

Follow-On Investments	Amount of Investment
HZO, Inc.	\$ 2,000,003
Enumeral Biomedical Holdings, Inc.	1,500,000
Produced Water Absorbents, Inc.	1,000,268
Produced Water Absorbents, Inc.	1,000,000
Enumeral Biomedical Corp.	935,000
D-Wave Systems, Inc.	762,568
Produced Water Absorbents, Inc.	750,000
ABSMaterials, Inc.	500,000
Senova Systems, Inc.	500,000
EchoPixel, Inc.	500,000
SiOnyx, Inc.	415,635
Senova Systems, Inc.	350,000
Produced Water Absorbents, Inc.	330,677
Enumeral Biomedical Corp.	250,000
Senova Systems, Inc.	250,000
OpGen, Inc.	250,000
OpGen, Inc.	245,017
Mersana Therapeutics, Inc.	240,500
OpGen, Inc.	209,020
HZO, Inc.	206,997
OpGen, Inc.	200,000
D-Wave Systems, Inc.	170,043
OpGen, Inc.	120,000
ProMuc, Inc.	100,000
OpGen, Inc.	100,000
SiOnyx, Inc.	93,976
Ultora, Inc.	86,039
SiOnyx, Inc.	68,999
Enumeral Biomedical Corp.	65,000
Laser Light Engines, Inc.	19,331
Ultora, Inc.	17,208
Laser Light Engines, Inc.	13,745
Ultora, Inc.	10,750

Total \$ 14,276,808

*December 31, 2013*

At December 31, 2013, our total assets and net assets were \$125,063,946 and \$122,701,575, respectively. At December 31, 2012, they were \$131,990,250 and \$128,436,774, respectively.

At December 31, 2013, our net asset value per share was \$3.93, as compared with \$4.13 at December 31, 2012. At December 31, 2013, and December 31, 2012, our shares outstanding were 31,197,438 and 31,116,881, respectively.

Significant developments in the year ended December 31, 2013, included a decrease in the holdings of our venture capital investments of \$14,102,732 and an increase in our cash and treasury holdings of \$5,160,367. The decrease in the value of our venture capital investments from \$108,002,191 at December 31, 2012, to \$93,899,459 at December 31, 2013, resulted primarily from a net decrease of \$16,302,653 owing to the sale of certain of our shares of Solazyme, Inc., Champions Oncology, Inc., and NeoPhotonics Corporation, a net decrease of \$12,303,684 owing to the sale of our investment in Xradia, Inc., and a net decrease in the net value of our venture capital investments of \$3,572,683, offset by an increase owing to two new and 37 follow-on investments of \$18,076,288. The increase in our cash and treasury holdings from \$22,377,991 at December 31, 2012, to \$27,538,358 at December 31, 2013, is primarily owing to net proceeds of \$16,302,653 received from the sale of certain of our shares of Solazyme, NeoPhotonics and Champions Oncology, net premium proceeds of \$629,921 received from certain Solazyme and NeoPhotonics option contracts, \$1,222,830 received from the portion of our payments held in escrow from the sales of Innovalight, Inc., and Crystal IS, Inc., and \$12,838,244 received from the sale of Xradia, Inc., offset by the payment of cash for operating expenses of \$7,317,388 and to new and follow-on venture capital investments totaling \$18,076,288.

The following table is a summary of additions to our portfolio of venture capital investments made during the year ended December 31, 2013:

New Investments	Amount of Investment
EchoPixel, Inc.	\$ 750,000
ProMuc, Inc.	350,001

Follow-On Investments	Amount of Investment
Adesto Technologies Corporation	\$ 2,499,999
Produced Water Absorbents, Inc.	1,802,760
Metabolon, Inc.	1,225,000
HzO, Inc.	1,212,500
HzO, Inc.	1,000,000
HzO, Inc.	937,500
Enumeral Biomedical Corp.	750,000
Adesto Technologies Corporation	672,070
Produced Water Absorbents, Inc.	648,000
ABSMaterials, Inc.	500,000
D-Wave Systems, Inc.	491,100
SiOnyx, Inc.	418,066
SiOnyx, Inc.	418,066
Senova Systems, Inc.	386,363
Ancora Pharmaceuticals Inc.	350,000
HzO, Inc.	350,000
Nano Terra, Inc.	350,000
Enumeral Biomedical Corp.	300,001
Ancora Pharmaceuticals, Inc.	300,000
AgBiome, LLC	260,870
AgBiome, LLC	260,870
Ultora, Inc.	236,603
Ultora, Inc.	215,000
Champions Oncology, Inc.	200,000
Laser Light Engines, Inc.	166,667
Laser Light Engines, Inc.	166,667
OpGen, Inc.	150,000
Mersana Therapeutics, Inc.	126,585
Senova Systems, Inc.	113,636
Senova Systems, Inc.	100,000
OpGen, Inc.	95,000
Laser Light Engines, Inc.	80,669
Ensemble Therapeutics Corporation	73,620
Kovio, Inc.	50,000
Cobalt Technologies, Inc.	28,920
Ensemble Therapeutics Corporation	25,767
Ensemble Therapeutics Corporation	13,988
Total	\$ 18,076,288

The following tables summarize the values of our portfolios of venture capital investments and U.S. government securities, as compared with their cost, at December 31, 2014, and December 31, 2013:

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

	December 31, 2014	December 31, 2013
Venture capital investments, at cost	\$ 112,371,315	\$ 115,929,793
Net unrealized (depreciation) <sup>(1)</sup>	(22,606,475 )	(22,030,334 )
Venture capital investments, at value	\$ <b>89,764,840</b>	\$ <b>93,899,459</b>

	December 31, 2014	December 31, 2013
U.S. government securities, at cost	\$ 0	\$ 18,999,765
Net unrealized appreciation <sup>(1)</sup>	0	45
U.S. government securities, at value	\$ 0	\$ 18,999,810

<sup>(1)</sup>At December 31, 2014, and December 31, 2013, the net accumulated unrealized depreciation on investments, including written call options was \$22,606,475 and \$22,021,407, respectively.

## **Cash Flow**

### ***Year Ended December 31, 2014***

Net cash provided by operating activities for the year ended December 31, 2014, was \$12,361,457, primarily reflecting the net sale of U.S. government securities of \$18,999,008 and proceeds from the sale of investments of \$13,655,918, offset by the purchase of venture capital investments of \$14,276,808 and the payment of operating expenses.

Net cash used in investing activities for the year ended December 31, 2014, was \$26,940, primarily reflecting the purchase of fixed assets.

Cash used in financing activities for the year ended December 31, 2014, was \$124,751, resulting from the net settlement of restricted stock awards.

### ***Year Ended December 31, 2013***

Net cash provided by operating activities for the year ended December 31, 2013, was \$295,923, primarily reflecting the net purchase of U.S. government securities of \$5,005,360, the purchase of venture capital investments of \$18,076,288 and the payment of operating expenses, partially offset by proceeds from the sale of investments of \$30,363,727 and net proceeds from call options of \$1,040,127.

Net cash used in investing activities for the year ended December 31, 2013, was \$13,303, primarily reflecting the purchase of fixed assets.

Cash used in financing activities for the year ended December 31, 2013, was \$123,183, resulting from the net settlement of restricted stock awards.

*Year Ended December 31, 2012*

Net cash used in operating activities for the year ended December 31, 2012, was \$(23,741,522), primarily reflecting the net purchase of U.S. government securities of \$13,993,650, the purchase of venture capital investments of \$16,511,941 and the payment of operating expenses, partially offset by proceeds from the sale of investments of \$8,132,435 and net proceeds from call options of \$1,640,557.

Net cash used in investing activities for the year ended December 31, 2012, was \$15,922, primarily reflecting the purchase of fixed assets.

Cash used in financing activities for the year ended December 31, 2012, was \$1,704,839, resulting from the repayment of our credit facility and the net settlement of restricted stock awards.



## **Liquidity and Capital Resources**

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

We fund our day-to-day operations using interest earned and proceeds from our cash holdings, the sales of our investments in U.S. government securities, when applicable, and interest earned from our venture debt securities. We believe the increase or decrease in the value of our venture capital investments does not materially affect the day-to-day operations of the Company or our daily liquidity. As of December 31, 2014, and December 31, 2013, we had no investments in money market mutual funds.

Our Loan Facility may be used to fund our investments and not for the payment of day-to-day operating expenses. As of December 31, 2014, we had no debt outstanding. We have not issued any debt securities, and, therefore, are not subject to credit agency downgrades.

As a venture capital company, it is critical that we have capital available to support our best companies until we have an opportunity for liquidity in our investments. As such, we seek to continue to maintain a substantial amount of liquid capital on our balance sheet.

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

Except for a rights offering, we are generally not able to issue and sell our common stock at a price below our net asset value per share, exclusive of any distributing commission or discount, without shareholder approval. As of December 31, 2014, our net asset value per share was \$3.51 per share and our closing market price was \$2.95 per share. We do not currently have shareholder approval to issue or sell shares below our net asset value per share.

***December 31, 2014***

At December 31, 2014, and December 31, 2013, our total net primary and secondary liquidity was \$29,620,665 and \$33,620,478, respectively.

At December 31, 2014, and December 31, 2013, our total net primary liquidity was \$20,978,792 and \$28,073,184, respectively. Our primary liquidity is principally comprised of our cash, U.S. government securities, when applicable, and certain receivables. The decrease in our primary liquidity from December 31, 2013, to December 31, 2014, is primarily owing to the use of funds for investments totaling \$14,276,808 and payment of net operating expenses, offset by the receipt of \$2,070,955 from our rights to milestone payments from Amgen, Inc., associated with the sale of BioVex Group, Inc., \$2,374,827 from the portion of our upfront payment held in escrow from the sale of Xradia, Inc., \$6,486,461 from the sale of Molecular Imprints, Inc., \$549,238 from the payment of the senior secured debt of OHSO Clean, Inc., \$48,071 from the payment of the principal amount plus accrued interest of a convertible promissory note invested in Nanosys, Inc., \$79,310 of total proceeds due of \$158,621 from the sale of certain warrants of GEO Semiconductor, Inc., with the remaining proceeds due of \$79,311 included in our receivables as of December 31, 2014, and net proceeds of \$2,043,780 from the sales of certain of our shares of Solazyme, Inc., and Champions Oncology, Inc. During the year ended December 31, 2014, we also purchased and sold call option contracts on our publicly traded positions generating net proceeds of \$119,697.

At December 31, 2014, and December 31, 2013, our secondary liquidity was \$8,641,873 and \$5,547,294, respectively. Secondary liquidity does not include the value of warrants or options we hold in Champions Oncology, Inc., or Enumeral Biomedical Holdings, Inc. Our secondary liquidity consists of our publicly traded securities. Although these companies are publicly traded, their stock may not trade at high volumes and prices can be volatile, which may restrict our ability to sell our positions at any given time. We may also be restricted for a period of time in selling our positions in these companies due to our shares being unregistered. As of December 31, 2014, our publicly traded securities of Enumeral Biomedical were restricted from sale.

We do not include funds held in escrow from the sale of investments in primary or secondary liquidity. These funds become primary liquidity if and when they are received at the expiration of the escrow period.

We believe that the current and future venture capital environment may adversely affect the valuation of investment portfolios, lead to tighter lending standards and result in reduced access to capital. These conditions may lead to a decline in net asset value and/or decline in valuations of our portfolio companies in future quarters. Although we cannot predict future market conditions, we continue to believe that our current cash and U.S. government security holdings and our ability to adjust our investment pace will provide us with adequate liquidity to execute our current business strategy.

On September 24, 2009, we signed a ten-year lease for approximately 6,900 square feet of office space located at 1450 Broadway, New York, New York. The lease commenced on January 21, 2010, with these offices replacing our corporate headquarters previously located at 111 West 57<sup>th</sup> Street in New York City. The base rent is \$36 per square foot with a 2.5 percent increase per year over the 10 years of the lease, subject to a full abatement of rent for four months and a rent credit for six months throughout the lease term. The lease expires on December 31, 2019. Total rent expense for this office space in New York City was \$253,446 in 2014, \$242,806 in 2013, and \$238,202 in 2012. Future minimum lease payments in each of the following years are: 2015 - \$280,673; 2016 - \$287,690; 2017 - \$294,882; 2018 - \$302,254; and 2019 - \$309,811.

On July 1, 2008, we signed a five-year lease for office space at 420 Florence Street, Suite 200, Palo Alto, California, which commenced on August 1, 2008, and expired on August 31, 2013. Total rent expense for this office space in Palo Alto was \$0 in 2014, \$92,787 in 2013 and \$136,816 in 2012.

On April 26, 2011, we signed a one-year lease for office space at 530 Lytton Avenue, 2<sup>nd</sup> Floor, Palo Alto, California, commencing on July 1, 2011, and expiring on June 30, 2012. The lease has been renewed annually commencing on July 1, 2012, and currently expires on June 30, 2015. Total rent expense for this office space in Palo Alto was \$40,474 in 2014, \$34,325 in 2013 and \$28,916 in 2012. Future minimum lease payments in 2015 are \$20,423.

On March 22, 2012, we signed a one-year lease for office space at 140 Preston Executive Drive, Space "L," Cary, North Carolina, commencing on April 1, 2012, and expiring on March 31, 2013. The lease was renewed commencing on April 1, 2013, and expired on March 31, 2014. Total rent expense for this office space in Cary was \$1,717 in 2014, \$6,442 in 2013 and \$4,725 in 2012.

On March 17, 2014, we signed a month-to-month lease for office space at 213 Fayetteville Street, Raleigh, North Carolina, commencing on March 24, 2014, through December 31, 2014. Total rent expense for this office space in Raleigh was \$3,411 in 2014.

### ***December 31, 2013***

At December 31, 2013, and December 31, 2012, our total net primary and secondary liquidity was \$33,643,980 and \$38,231,691, respectively.

At December 31, 2013, and December 31, 2012, our total net primary liquidity was \$28,073,184 and \$22,461,202, respectively. Our primary liquidity is principally comprised of our cash, U.S. government securities, when applicable, and certain receivables. The increase in our primary liquidity from December 31, 2012, to December 31, 2013, is primarily owing to the receipt of our initial payment of \$12,838,244 from the sale of Xradia, Inc., the receipt of \$1,222,830 from the portion of our upfront payments held in escrow from the sale of Innovalight, Inc., and Crystal IS, Inc., and net proceeds of \$16,302,653 received from the sales of certain of our shares of Solazyme, Inc., Champions Oncology, Inc., and NeoPhotonics Corporation, offset by the use of funds for investments and payment of net operating expenses. During the year ended December 31, 2013, we also purchased and sold call option and put option contracts on our publicly traded positions generating net proceeds of \$629,291.

At December 31, 2013, and December 31, 2012, our secondary liquidity was \$5,570,796 and \$15,770,489, respectively. Our secondary liquidity consists of our publicly traded securities. Although these companies are publicly traded, their stock may not trade at high volumes and prices can be volatile, which may restrict our ability to sell our positions at any given time. We may also be restricted for a period of time in selling our positions in these companies due to our shares being unregistered.

We do not include funds held in escrow from the sale of investments in primary or secondary liquidity. These funds become primary liquidity if and when they are received at the expiration of the escrow period.

## **Borrowings**

On September 30, 2013, the Company entered into the Loan Facility, which may be used to fund investments in portfolio companies. The Loan Facility replaced the Company's prior credit facility with TD Bank, NA. The Loan Facility, among other things, matures on September 30, 2017, and bears interest at 10 percent per annum in cash. The Company has the option to have interest accrue at a rate of 13.5 percent per annum if the Company decides not to pay interest in cash monthly. The Company currently plans to pay interest in cash if and when any borrowings are outstanding. The Loan Facility also requires payment of a draw fee on each borrowing equal to 1.0 percent of such borrowing and an unused commitment fee of 1.0 percent per annum. Interest and fee payments under the Loan Facility are made quarterly in arrears. The Company may prepay the loans or reduce the aggregate commitments under the Loan Facility at any time prior to the maturity date, as long as certain conditions are met, including payment of required prepayment or termination fees. The Loan Facility is secured by all of the assets of the Company and its wholly owned subsidiaries, subject to certain customary exclusions. The Loan Facility contains certain affirmative and negative covenants, including without limitation: (a) maintenance of certain minimum liquidity requirements; (b) maintenance of an eligible asset leverage ratio of not less than 4.0:1.0; (c) limitations on liens; (d) limitations on the incurrence of additional indebtedness; and (e) limitations on structural changes, mergers and disposition of assets (other than in the normal course of our business activities). There were no borrowings at closing, and at December 31, 2014, and December 31, 2013, the Company had no outstanding debt.

On September 30, 2013, the Company terminated its prior credit facility with TD Bank, N.A. As of December 31, 2013, there was no principal outstanding under the prior credit facility and no termination fees were incurred in connection with terminating the prior credit facility.

At December 31, 2014, and December 31, 2013, the Company had no outstanding debt. The weighted average annual interest rate for the year ended December 31, 2014, and December 31, 2013, was zero percent, exclusive of amortization of closing fees and other expenses related to establishing the prior credit facility. The remaining capacity under the Loan Facility was \$20,000,000 at December 31, 2014. Unamortized fees and expenses of \$480,921 related to establishing the Loan Facility are included as "Prepaid expenses" as of December 31, 2014. These amounts are amortized over the term of the Loan Facility. At December 31, 2014, the Company was in compliance with all covenants required by the Loan Facility.

Legislation was introduced in the U.S. House of Representatives during the 113<sup>th</sup> Congress intended to revise certain regulations applicable to BDCs. The legislation, among other things, provides for increasing the amount of funds BDCs may borrow by reducing the asset coverage ratio from 200 percent to 150 percent. As a result, we may be able to incur additional indebtedness in the future, and, therefore, the risk of an investment in shares of our common stock may increase.

## Contractual Obligations

A summary of our significant contractual payment obligations is as follows:

### Payments Due by Period

	<b>Total</b>	<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	<b>More Than 5 Years</b>
Multi-Draw Loan Facility <sup>(1)</sup>	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Operating leases	\$1,495,733	\$301,096	\$582,572	\$612,065	\$ 0

<sup>(1)</sup>As of December 31, 2014, we had \$20,000,000 of unused borrowing capacity under our Loan Facility.

On July 21, 2014, the Company made a \$216,012 investment in Accelerator IV-New York Corporation. This initial investment was part of an overall \$666,667 operating commitment to Accelerator IV-New York Corporation. In addition to this operating commitment, the Company has a \$3,333,333 investment commitment to be invested in portfolio companies over a five-year period. If the Company defaults on these commitments, the other investors may purchase the Company's shares of Accelerator IV-New York Corporation for \$.001 per share. In the event of default, the Company would still be required to contribute the remaining operating commitment.

The Company's aggregate operating and investment commitments in Accelerator amounted to \$666,667 and \$3,333,333, respectively. During the year ended December 31, 2014, \$216,012 in capital was called, all of which related to the operating commitment. As of December 31, 2014, the Company had remaining unfunded commitments of \$450,655 and \$3,333,333, or approximately 67.6 percent and 100 percent, of the total operating and investment commitments, respectively. The withdrawal of contributed capital is not permitted. The transfer or assignment of capital is subject to approval by Accelerator.

## Critical Accounting Policies

The Company's significant accounting policies are described in Note 2 to the Consolidated Financial Statements and in the Footnote to the Consolidated Schedule of Investments. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and those that require management's most difficult, complex or subjective judgments. The Company considers the following accounting policies and

related estimates to be critical:

Valuation of Portfolio Investments

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

90



Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the SEC and U.S. GAAP. ASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. ASC 820 provides a consistent definition of fair value that focuses on exit price in the principal, or most advantageous, market and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. ASC 820 also establishes the following three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date.

- Level 1 - inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;
- Level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 2 inputs are in those markets for which there are few transactions, the prices are not current, little public information exists or instances where prices vary substantially over time or among brokered market makers; and
- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement. Unobservable inputs are those inputs that reflect our own assumptions that market participants would use to price the asset or liability based upon the best available information.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement and are not necessarily an indication of risks associated with the investment. See "Note 5. Fair Value of Investments" in the accompanying notes to our consolidated financial statements for additional information regarding fair value measurements.

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" for additional information. As of December 31, 2014, our financial statements include venture capital investments valued at \$88,374,145, the fair values of which were determined in good faith by, or under the direction of, the Board of Directors. As of December 31, 2014, approximately 81 percent of our net assets represent investments in portfolio companies at fair value by the Board of Directors.

Effective September 30, 2014, the Company refined its valuation methodologies to include the option pricing model. While the Company's valuation procedures had always included the option pricing model as a possible valuation

technique, it had not previously been utilized. The use of the option pricing model is emerging as a preferred industry practice. This change in valuation methodology is applied on a prospective basis.

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

In addition, with respect to our debt investments for which no readily available market quotations are available, we will generally consider the financial condition and current and expected future cash flows of the portfolio company; the creditworthiness of the portfolio company and its ability to meet its current debt obligations; the relative seniority of our debt investment within the portfolio company's capital structure; the availability and value of any available collateral; and changes in market interest rates and credit spreads for similar debt investments.

Historically, difficult venture capital environments have resulted in companies not receiving financing and being subsequently closed down with a loss of investment to venture investors, and other companies receiving financing but at significantly lower valuations than the preceding rounds, leading to very deep dilution for those who do not participate in the new rounds of investment. Our best estimate of this non-performance risk has been quantified and included in the valuation of our portfolio companies as of December 31, 2014.

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

As of December 31, 2014, approximately 98.5 percent of our portfolio company investments were classified as Level 3 in the hierarchy, indicating a high level of judgment required in their valuation.

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



### Stock-Based Compensation

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

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

Management uses a binomial lattice option pricing model in instances where it is necessary to include a broader array of assumptions. We used the binomial lattice model for the 10-year NQSOs granted on March 18, 2009, and for performance-based restricted stock awards. These awards included accelerated vesting provisions or target stock prices that were based on market conditions.

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

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

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

GAAP requires us to develop an estimate of the number of share-based awards that will be forfeited owing to employee turnover. Quarterly changes in the estimated forfeiture rate can have a significant effect on reported

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

### Pension and Post-Retirement Benefit Plan Assumptions

The Company provides a Retiree Medical Benefit Plan for employees who meet certain eligibility requirements. Until it was terminated on May 5, 2011, the Company also provided an Executive Mandatory Retirement Benefit Plan for certain individuals employed by us in a bona fide executive or high policy-making position. Our former President accrued benefits under this plan prior to his retirement, and the termination of the plan has no impact on his accrued benefits. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability values related to our post-retirement benefit plans. These factors include assumptions we make about the discount rate, the rate of increase in healthcare costs, and mortality, among others.

The discount rate reflects the current rate at which the post-retirement medical benefit and pension liabilities could be effectively settled considering the timing of expected payments for plan participants. In estimating this rate, we consider the Citigroup Pension Liability Index in the determination of the appropriate discount rate assumptions. The weighted average rate we utilized to measure our post retirement medical benefit obligation as of December 31, 2014, and to calculate our 2015 expense was 3.83 percent. We used a discount rate of 2.95 percent to calculate our pension obligation for the Executive Mandatory Retirement Benefit Plan.

### **Recent Developments - Portfolio Companies**

On January 21, 2015, the Company made a \$195,303 follow-on investment in Nantero, Inc., a privately held portfolio company.

On January 23, 2015, the Company made a \$500,000 follow-on investment in Produced Water Absorbents, Inc., a privately held portfolio company.

On January 29, 2015, the Company made a \$103,500 follow-on investment in SiOnyx, Inc., a privately held portfolio company.

On January 29, 2015, the Company made a \$262,215 follow-on investment in Accelerator IV-New York Corporation, a privately held portfolio company. This investment was made pursuant to our operating commitment of which \$188,440 remains unfunded. We continue to have an unfunded investment commitment of \$3,333,333.

On February 5, 2015, the Company made a \$250,000 new investment in Orig3n, Inc., a privately held portfolio company.

On February 5, 2015, the Company made a \$200,000 new investment in Phylagen, Inc., a privately held portfolio company.

On February 17, 2015, the Company made a \$484,203 follow-on investment in Produced Water Absorbents, Inc., a privately held portfolio company.



On February 17, 2015, the Company made a \$208,035 follow-on investment in OpGen, Inc., a privately held portfolio company.

On February 20, 2015, the Company made a \$104,521 follow-on investment in Mersana Therapeutics, Inc., a privately held portfolio company.

On March 2, 2015, the Company made a \$300,000 follow-on investment in Metabolon, Inc., a privately held portfolio company.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

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

#### **Valuation Risk**

Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which market quotations are readily available and (ii) fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See the "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments" contained in "Item 8. Consolidated Financial Statements and Supplementary Data.")

Because there is typically no public market for our interests in the privately held small businesses in which we invest, the valuation of the equity interests in that portion of our portfolio is determined in good faith by our Board of Directors with the assistance of our Valuation Committee, comprised of the independent members of our Board of Directors, in accordance with our Valuation Procedures. In the absence of a readily ascertainable market value, the determined value of our portfolio of equity interests may differ significantly from the values that would be placed on the portfolio if a ready market for the equity interests existed. Determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment, although our valuation policy is intended to provide a consistent basis for determining fair value of the portfolio investments. Factors that may be considered include, but are not limited to, readily available public market quotations; the cost of the Company's investment; transactions in the portfolio company's securities or unconditional firm offers by responsible parties; the financial condition and operating results of the company; the long-term potential of the business and technology of the company; the estimated time to exit our investment; the values and volatilities of similar securities issued by companies in similar businesses; multiples to revenues, net income or EBITDA that similar securities issued by

companies in similar businesses receive; the proportion of the company's securities we own and the nature of any rights to require the company to register restricted securities under the applicable securities laws; management's assessment of non-performance risk; the achievement of milestones; and the rights and preferences of the class of securities we own as compared with other classes of securities the portfolio has issued.

In addition, with respect to our debt investments for which no readily available market quotations are available, we will generally consider the financial condition and current and expected future cash flows of the portfolio company; the creditworthiness of the portfolio company and its ability to meet its current debt obligations; the relative seniority of our debt investment within the portfolio company's capital structure; the availability and value of any available collateral; and changes in market interest rates and credit spreads for similar debt investments. Any changes in valuation are recorded in our Consolidated Statements of Operations as "Net increase (decrease) in unrealized appreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

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

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

### ***Interest Rate Risk***

Interest rate sensitivity refers to the change in earnings that may result from changes in the level of interest rates. Our borrowings under our Loan Facility bear interest at a fixed rate of 10 percent per annum, and, therefore, changes in interest rate benchmarks, such as LIBOR, will not affect our earnings on such investments if we decide to fund them through draws from our Loan Facility.

We may also invest in both short- and long-term U.S. government and agency securities. To the extent that we invest in short- and long-term U.S. government and agency securities, changes in interest rates result in changes in the value of these obligations that result in an increase or decrease of our net asset value. The level of interest rate risk exposure at any given point in time depends on the market environment, the expectations of future price and market movements, and the quantity and duration of long-term U.S. government and agency securities held by the Company, and it will vary from period to period.

In addition, market interest rates for high-yield corporate debt are an input in determining value of our investments in debt securities of privately held and publicly traded companies. Significant changes in these market rates could affect

the value of our debt securities as of the date of measurement of value. Our investment income could be adversely affected should such debt securities include floating interest rates. We do not currently have any investments in debt securities with floating interest rates.

*Foreign Currency Risk*

Most of our investments are denominated in U.S. dollars. We currently have one investment denominated in Canadian dollars. We are exposed to foreign currency risk related to potential changes in foreign currency exchange rates. The potential loss in fair value on this investment resulting from a 10 percent adverse change in quoted foreign currency exchange rates is \$530,304 at December 31, 2014.

**Item 8. Consolidated Financial Statements and Supplementary Data.**

**HARRIS & HARRIS GROUP, INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES**

The following reports and consolidated financial schedules of Harris & Harris Group, Inc. are filed herewith and included in response to Item 8.

	Page
<u>Documents</u>	
<u>Management's Report on Internal Control Over Financial Reporting</u>	99
<u>Report of Independent Registered Public Accounting Firm</u>	100
<u>Consolidated Financial Statements</u>	
<u>Consolidated Statements of Assets and Liabilities as of December 31, 2014, and 2013</u>	102
<u>Consolidated Statements of Operations for the years ended December 31, 2014, 2013, and 2012</u>	103
<u>Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2014, 2013, and 2012</u>	104
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013, and 2012</u>	105
<u>Consolidated Statements of Changes in Net Assets for the years ended December 31, 2014, 2013, and 2012</u>	106
<u>Consolidated Schedule of Investments as of December 31, 2014</u>	107
<u>Consolidated Schedule of Investments as of December 31, 2013</u>	120
<u>Footnote to Consolidated Schedule of Investments</u>	132
<u>Notes to Consolidated Financial Statements</u>	138
<u>Financial Highlights for the years ended December 31, 2014, 2013, 2012, 2011 and 2010</u>	170



## **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 Exchange Act 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, 2014. 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 (2013). Based on the results of this assessment, management (including our Chief Executive Officer and Chief Financial Officer) has concluded that, as of December 31, 2014, the Company's internal control over financial reporting was effective.

The effectiveness of the Company's internal control over financial reporting has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in its report which appears on page 100 of this Annual Report on Form 10-K.



## Report of Independent Registered Public Accounting Firm

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

In our opinion, the accompanying consolidated statements of assets and liabilities, including the consolidated schedules of investments, and the related consolidated statements of operations, of comprehensive income, of changes in net assets and of cash flows and the financial highlights present fairly, in all material respects, the financial position of Harris & Harris Group, Inc. and its subsidiaries (hereafter referred to as the "Company") at December 31, 2014 and December 31, 2013, and the results of their operations and their cash flows, and the changes in their net assets for each of the three years in the period ended December 31, 2014, and the financial highlights for each of the five years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, the financial highlights and the financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedule and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. Our procedures included confirmation of securities at December 31, 2014 by correspondence with the custodian. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2, the financial statements include fair value measurements which have been estimated by the Board of Directors using significant unobservable inputs in the absence of observable inputs. As discussed in Note 2, at December 31, 2014, fair value measurements estimated using significant unobservable inputs are \$88,680,947 (80.9% of net assets).

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.

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

New York, New York

March 16, 2015

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

	December 31, 2014	December 31, 2013
<b>ASSETS</b>		
Investments, in portfolio securities at value:		
Unaffiliated privately held companies (cost: \$22,304,047 and \$29,277,213, respectively)	\$ 13,854,906	\$ 29,199,564
Unaffiliated rights to milestone payments (adjusted cost basis: \$2,387,278 and \$3,291,750, respectively)	3,193,865	3,489,433
Unaffiliated publicly traded securities (cost: \$1,741,128 and \$2,451,410, respectively)	1,398,085	5,570,796
Non-controlled affiliated privately held companies (cost: \$67,236,533 and \$71,843,448, respectively)	58,470,864	54,287,040
Non-controlled affiliated publicly traded companies (cost: \$5,591,299 and \$0, respectively)	8,384,641	0
Controlled affiliated privately held companies (cost: \$13,111,030 and \$9,065,972, respectively)	4,462,479	1,352,626
Total, investments in private portfolio companies, rights to milestone payments and public securities at value (cost: \$112,371,315 and \$115,929,793, respectively)	\$ 89,764,840	\$ 93,899,459
Investments, in U.S. Treasury securities at value (cost: \$0 and \$18,999,765, respectively)	0	18,999,810
Cash	20,748,314	8,538,548
Receivable from sales of investments (Note 2)	0	448,886
Funds held in escrow from sales of investments at value (Note 2)	306,802	1,786,390
Receivable from portfolio company	160,877	54,160
Interest receivable	62,482	22,804
Prepaid expenses	754,856	991,409
Other assets	296,690	322,480
Total assets	\$ 112,094,861	\$ 125,063,946
<b>LIABILITIES &amp; NET ASSETS</b>		
Post retirement plan liabilities (Note 9)	\$ 1,267,615	\$ 1,120,262
Accounts payable and accrued liabilities	841,915	785,608
Deferred rent	330,904	353,001
Written call options payable (premiums received: \$0 and \$112,382, respectively) (Note 6)	0	103,500
Total liabilities	\$ 2,440,434	\$ 2,362,371
Commitments and contingencies (Note 11)		
Net assets	\$ 109,654,427	\$ 122,701,575

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 12/31/14 and 12/31/13; 33,109,583 issued at 12/31/14 and 33,026,178 issued at 12/31/13	331,096	330,262
Additional paid in capital (Note 7)	215,051,662	214,320,241
Accumulated net operating and realized loss	(80,434,528)	(67,449,176)
Accumulated unrealized depreciation of investments	(22,606,475)	(22,021,407)
Accumulated other comprehensive income (Note 9)	718,203	927,186
Treasury stock, at cost (1,828,740 shares at 12/31/14 and 12/31/13)	(3,405,531)	(3,405,531)
Net assets	\$ 109,654,427	\$ 122,701,575
Shares outstanding	31,280,843	31,197,438
Net asset value per outstanding share	\$ 3.51	\$ 3.93

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

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

	Year Ended December 31, 2014	Year Ended December 31, 2013	Year Ended December 31, 2012
Investment income:			
Interest from:			
Unaffiliated companies	\$ 121,345	\$ 245,377	\$ 252,138
Non-controlled affiliated companies	91,768	(17,877)	) 91,500
Controlled affiliated companies	155,827	101,723	169,554
Cash and U.S. Treasury securities and other	9,583	15,436	45,175
Fees for providing managerial assistance to portfolio companies	86,667	0	0
Yield-enhancing fees on debt securities	52,610	46,243	56,274
Rental income from sublease	0	80,000	107,586
Total investment income	517,800	470,902	722,227
Expenses:			
Salaries, benefits and stock-based compensation (Note 7)	4,869,716	5,352,672	6,582,714
Administration and operations	679,630	654,949	702,588
Professional fees	1,384,716	1,255,796	1,001,772
Rent (Note 11)	299,048	376,360	408,659
Insurance expense	321,713	377,545	377,065
Directors' fees and expenses	373,627	245,801	296,708
Interest and other debt expense	377,658	116,421	48,126
Custody fees	60,070	58,458	49,349
Depreciation	53,349	55,106	58,589
Total expenses	8,419,527	8,493,108	9,525,570
Net operating loss	(7,901,727)	) (8,022,206)	) (8,803,343)
Net realized (loss) gain:			
Realized gain (loss) from investments:			
Unaffiliated companies	4,031,521	105,313	546,055
Unaffiliated rights to milestone payments	536,813	0	0
Non-controlled affiliated companies	(11,199,639)	) 6,388,601	475,844
Publicly traded companies	1,333,497	12,123,019	(205,919)
Written call options	232,079	(282)	) 1,605,907
Purchased put options	0	(72,209)	) 0
U.S. Treasury securities/other	0	(180)	) (218)
Realized (loss) gain from investments	(5,065,729)	) 18,544,262	2,421,669
Income tax expense (Note 10)	17,896	27,994	15,236

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

Net realized (loss) gain from investments	(5,083,625	)	18,516,268	2,406,433
Net (increase) decrease in unrealized depreciation on investments:				
Investments	(576,186	)	(18,284,402	) (13,477,490
Written call options	(8,882	)	1,382	(112,500
Net (increase) decrease in unrealized depreciation on investments	(585,068	)	(18,283,020	) (13,589,990
Net realized and unrealized (loss) gain on investments	\$ (5,668,693	)	\$ 233,248	\$ (11,183,557
Net decrease in net assets resulting from operations:				
Total	\$ (13,570,420	)	\$ (7,788,958	) \$ (19,986,900
Per average basic and diluted outstanding share	\$ (0.43	)	\$ (0.25	) \$ (0.65
Average outstanding shares – basic and diluted	31,222,877		31,138,716	31,000,919

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

**HARRIS & HARRIS GROUP, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	Year Ended December 31, 2014	)	Year Ended December 31, 2013	)	Year Ended December 31, 2012	)
Net decrease resulting from operations	\$ (13,570,420	)	\$ (7,788,958	)	\$ (19,986,900	)
Other comprehensive (loss) income:						
Prior service cost (Note 9)	0		1,101,338		0	
Amortization of prior service cost	(208,983	)	(174,152	)	0	
Other comprehensive (loss) income	(208,983	)	927,186		0	
Comprehensive loss	\$ (13,779,403	)	\$ (6,861,772	)	\$ (19,986,900	)

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, 2014	Year Ended December 31, 2013	Year Ended December 31, 2012
Cash flows provided by (used in) operating activities:			
Net decrease in net assets resulting from operations	\$ (13,570,420	) \$ (7,788,958	) \$ (19,986,900 )
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided by (used in) operating activities:			
Net realized (loss) gain and change in unrealized depreciation on investments	5,650,797	(261,242	) 11,168,321
Depreciation of fixed assets, amortization of premium or discount on U.S. government securities and prepaid assets and accretion of bridge note interest	(109,857	) 35,600	(161,781 )
Stock-based compensation expense	857,006	1,249,756	2,928,943
Amortization of prior service cost	(208,983	) (174,152	) 0
Purchase of U.S. government securities	(19,999,044	) (144,596,150	) (36,492,162 )
Sale of U.S. government securities	38,998,052	139,590,790	22,498,512
Purchase of affiliated portfolio companies	(14,016,308	) (17,257,408	) (14,102,326 )
Purchase of unaffiliated portfolio companies	(240,500	) (818,880	) (2,409,615 )
Payments received on debt investments	953,997	860,641	623,428
Proceeds from sale of investments	13,655,918	29,916,408	8,201,603
Proceeds from call option premiums	338,229	1,040,127	3,082,636
Payments for put and call option purchases	(218,532	) (410,363	) (1,442,079 )
Changes in assets and liabilities:			
Restricted funds	0	10,015	1,502,016
Receivable from portfolio company	(106,717	) (30,330	) 13,501
Interest receivable	(39,678	) 26,264	(34,433 )
Prepaid expenses	236,553	(193,999	) 301,448
Other assets	(619	) 12,937	6,636
Post retirement plan liabilities	147,353	17,753	215,489
Accounts payable and accrued liabilities	56,307	(216,910	) 355,244
Deferred rent	(22,097	) (15,976	) (10,003 )
Net cash provided by (used in) operating activities	12,361,457	995,923	(23,741,522 )
Cash flows from investing activities:			
Purchase of fixed assets	(26,940	) (13,303	) (15,922 )
Net cash used in investing activities	(26,940	) (13,303	) (15,922 )



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

Cash flows from financing activities:

Payment of withholdings related to net settlement of restricted stock	(124,751	)	(123,183	)	(204,839	)
Payment of loan facility closing fees	0		(700,000	)	0	
Payment of credit facility (Note 4)	0		0		(1,500,000	)
Net cash used in financing activities	(124,751	)	(823,183	)	(1,704,839	)
Net increase (decrease) in cash	\$ 12,209,766		\$ 159,437		\$ (25,462,283	)
Cash at beginning of the year	8,538,548		8,379,111		33,841,394	
Cash at end of the year	\$ 20,748,314		\$ 8,538,548		\$ 8,379,111	
Supplemental disclosures of cash flow information:						
Income taxes paid	\$ 17,896		\$ 24,177		\$ 8,075	
Interest paid	\$ 0		\$ 0		\$ 27,112	

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

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

	Year Ended December 31, 2014	)	Year Ended December 31, 2013	)	Year Ended December 31, 2012	)
Changes in net assets from operations:						
Net operating loss	\$ (7,901,727	)	\$ (8,022,206	)	\$ (8,803,343	)
Net realized (loss) gain on investments	(5,083,625	)	18,516,268	)	2,406,433	)
Net (increase) in unrealized depreciation on investments	(576,186	)	(18,284,402	)	(13,477,490	)
Net (decrease) increase in unrealized appreciation on written call options	(8,882	)	1,382	)	(112,500	)
Net decrease in net assets resulting from operations	(13,570,420	)	(7,788,958	)	(19,986,900	)
Changes in net assets from capital stock transactions:						
Acquisition of vested restricted stock awards to pay required employee withholding tax	(124,751	)	(123,183	)	(203,676	)
Stock-based compensation expense	857,006	)	1,249,756	)	2,928,943	)
Net increase in net assets resulting from capital stock transactions	732,255	)	1,126,573	)	2,725,267	)
Changes in net assets from accumulated other comprehensive (loss) income:						
Other comprehensive (loss) income	(208,983	)	927,186	)	0	)
Net (decrease) increase in net assets resulting from accumulated other comprehensive (loss) income	(208,983	)	927,186	)	0	)
Net decrease in net assets	(13,047,148	)	(5,735,199	)	(17,261,633	)
Net Assets:						
Beginning of the year	122,701,575	)	128,436,774	)	145,698,407	)
End of the year	\$ 109,654,427	)	\$ 122,701,575	)	\$ 128,436,774	)

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 16.8% of net assets at value					
Private Placement Portfolio (Illiquid) (4) – 12.6% of net assets at value					
Bridgelux, Inc. (5)(8)(9)					
Manufacturing high-power light emitting diodes (LEDs) and arrays					
Series B Convertible Preferred Stock	(M)		\$1,000,000	1,861,504	\$607,692
Series C Convertible Preferred Stock	(M)		1,352,196	2,130,699	826,294
Series D Convertible Preferred Stock	(M)		1,371,622	999,999	787,915
Series E Convertible Preferred Stock	(M)		672,599	440,334	724,344
Series E-1 Convertible Preferred Stock	(M)		386,073	399,579	499,686
Warrants for Series C Convertible Preferred Stock expiring 8/31/15	(I)		168,270	163,900	32,815
Warrants for Series D Convertible Preferred Stock expiring 8/31/15	(I)		128,543	166,665	35,139
Warrants for Series E Convertible Preferred Stock expiring 12/31/17	(I)		93,969	170,823	36,448
Warrants for Common Stock expiring 6/1/16	(I)		72,668	132,100	6,562
Warrants for Common Stock expiring 8/9/18	(I)		148,409	171,183	29,966
Warrants for Common Stock expiring 10/21/18	(I)		18,816	84,846	4,215
			5,413,165		3,591,076
Cambrios Technologies Corporation (5)(8)(9)					
Developing nanowire-enabled electronic materials for the display industry					
Series B Convertible Preferred Stock	(I)		1,294,025	1,294,025	41,829
Series C Convertible Preferred Stock	(I)		1,300,000	1,300,000	42,022
Series D Convertible Preferred Stock	(I)		515,756	515,756	358,416
Series D-2 Convertible Preferred Stock	(I)		92,400	92,400	32,361
Series D-4 Convertible Preferred Stock	(I)		216,168	216,168	75,708
			3,418,349		550,336
Cobalt Technologies, Inc. (5)(8)(9)(10)					
Developing processes for making bio- butanol through biomass fermentation					
Series C-1 Convertible Preferred Stock	(M)		749,998	352,112	0
Series D-1 Convertible Preferred Stock	(M)		122,070	48,828	0

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

Series E-1 Convertible Preferred Stock	(M)	114,938	46,089	0
Warrants for Series E-1 Pref. Stock expiring on 10/9/22	(I)	2,781	1,407	0
Warrants for Series E-1 Pref. Stock expiring on 3/11/23	(I)	5,355	2,707	0
		995,142		0

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

## HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 16.8% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) – 12.6% of net assets at value (Cont.)					
GEO Semiconductor Inc. (5)(11)					
Developing programmable, high-performance video and geometry processing solutions					
Loan and Security Agreement with GEO Semiconductor relating to the following assets:					
Warrants for Series A Pref. Stock expiring on 3/1/18	(I)		\$7,512	10,000	\$10,919
Warrants for Series A-1 Pref. Stock expiring on 6/29/18	(I)		7,546	10,000	12,010
			15,058		22,929
Mersana Therapeutics, Inc. (5)(8)(9)(12)					
Developing antibody drug conjugates for cancer therapy					
Series A-1 Convertible Preferred Stock	(I)		683,538	635,081	434,387
Common Stock	(I)		3,875,395	350,539	138,048
			4,558,933		572,435
Molecular Imprints, Inc. (5)(8)(9)(13)					
Manufacturing nanoimprint lithography capital equipment for non-semiconductor manufacturing markets					
Series A Convertible Preferred Stock	(M)		928,884	928,884	928,884
Nanosys, Inc. (5)(8)					
Developing inorganic nanowires and quantum dots for use in LED-backlit devices					
Series C Convertible Preferred Stock	(M)		1,500,000	803,428	932,035
Series D Convertible Preferred Stock	(M)		3,000,003	1,016,950	2,530,003
Series E Convertible Preferred Stock	(M)		496,573	433,688	844,004
			4,996,576		4,306,042

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 16.8% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) – 12.6% of net assets at value (Cont.)					
Nano Terra, Inc. (5) Developing surface chemistry and nano- manufacturing solutions		Energy			
Senior secured debt, 12.0%, maturing on 12/1/15	(I)		\$349,966	\$385,369	\$383,180
Warrants for Series A-2 Pref. Stock expiring on 2/22/21	(I)		69,168	446,248	13
Warrants for Series C Pref. Stock expiring on 11/15/22	(I)		35,403	241,662	66,673
			454,537		449,866
Nantero, Inc. (5)(8)(9) Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes		Electronics			
Series A Convertible Preferred Stock	(I)		489,999	345,070	1,440,529
Series B Convertible Preferred Stock	(I)		323,000	207,051	871,532
Series C Convertible Preferred Stock	(I)		571,329	188,315	941,639
Series D Convertible Preferred Stock	(I)		139,075	35,569	179,638
			1,523,403		3,433,338
Total Unaffiliated Private Placement Portfolio (cost: \$22,304,047)					\$13,854,906
Rights to Milestone Payments (Illiquid) (6) – 2.9% of net assets at value					
Amgen, Inc. (8)(9) Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	(I)	Life Sciences	\$1,757,608	\$1,757,608	\$2,564,917
Laird Technologies, Inc. (8)(9) Rights to Milestone Payments from Merger &	(I)	Energy	0	0	0



Acquisition of Nextreme Thermal Solutions,  
Inc.

Canon, Inc. (8)(9)		Electronics			
Rights to Milestone Payments from Acquisition of Molecular Imprints, Inc.	( I )		629,670	\$629,670	628,948
Total Unaffiliated Rights to Milestone Payments (cost: \$2,387,278)					\$3,193,865

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

HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Publicly Traded Portfolio (7) – 1.3% of net assets at value					
Solazyme, Inc. (5)(9) Developing algal biodiesel, industrial chemicals and specialty ingredients using synthetic biology Common Stock	(M)	Energy	\$ 118,099	50,000	\$ 129,000
Champions Oncology, Inc. (5)(9) Developing its TumorGraft™ platform for personalized medicine and drug development Common Stock	(M)	Life Sciences	1,622,629	2,523,895	1,261,695
Warrants for Common Stock expiring 1/29/18	(I)		400	40,000	7,390
			1,623,029		1,269,085
Total Unaffiliated Publicly Traded Portfolio (cost: \$1,741,128)					\$ 1,398,085
Total Investments in Unaffiliated Companies (cost: \$26,432,453)					\$ 18,446,856

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 61.0% of net assets at value					
Private Placement Portfolio (Illiquid) (14) – 53.3% of net assets at value					
ABSMaterials, Inc. (5)(8)(9) Developing nano-structured absorbent materials for environmental remediation		Energy			
Series A Convertible Preferred Stock	( I )		\$435,000	390,000	\$291,875
Series B Convertible Preferred Stock	( I )		1,217,644	1,037,751	1,255,717
			1,652,644		1,547,592
Accelerator IV-New York Corporation (8)(9)(15)(16) Identifying and managing emerging biotechnology companies		Life Sciences			
Series A Common Stock	( I )		216,012	216,012	51,627
Adesto Technologies Corporation (5)(8)(9)(17) Developing low-power, high-performance memory devices		Electronics			
Series A Convertible Preferred Stock	( H )		2,200,000	6,547,619	1,652,609
Series B Convertible Preferred Stock	( H )		2,200,000	5,952,381	1,527,457
Series C Convertible Preferred Stock	( H )		1,485,531	2,122,187	632,526
Series D Convertible Preferred Stock	( H )		1,393,147	1,466,470	612,462
Series D-1 Convertible Preferred Stock	( H )		703,740	987,706	356,159
Series E Convertible Preferred Stock	( H )		2,499,999	3,508,771	10,042,110
			10,482,417		14,823,323
AgBiome, LLC (5)(8)(9) Providing early-stage research and discovery for agriculture and utilizing the crop microbiome to identify products that reduce risk and improve yield		Life Sciences			
Series A-1 Convertible Preferred Stock	( I )		2,000,000	2,000,000	2,406,210
Series A-2 Convertible Preferred Stock	( I )		521,740	417,392	583,494

2,521,740

2,989,704

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 61.0% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (14) – 53.3% of net assets at value (Cont.)					
D-Wave Systems, Inc. (8)(18) Developing high-performance quantum computing systems		Electronics			
Series 1 Class B Convertible Preferred Stock	(H)		\$1,002,074	1,144,869	\$1,766,715
Series 1 Class C Convertible Preferred Stock	(H)		487,804	450,450	699,457
Series 1 Class D Convertible Preferred Stock	(H)		748,473	855,131	1,327,843
Series 1 Class E Convertible Preferred Stock	(H)		248,049	269,280	435,260
Series 1 Class F Convertible Preferred Stock	(H)		238,323	258,721	418,193
Series 1 Class H Convertible Preferred Stock	(H)		909,088	460,866	870,998
Series 2 Class D Convertible Preferred Stock	(H)		736,019	678,264	1,053,205
Series 2 Class E Convertible Preferred Stock	(H)		659,493	513,900	839,844
Series 2 Class F Convertible Preferred Stock	(H)		633,631	493,747	806,909
Warrants for Common Stock expiring 6/30/15	(I)		98,644	153,890	108,479
Warrants for Common Stock expiring 5/12/19	(I)		26,357	20,415	8,351
			5,787,955		8,335,254
EchoPixel, Inc. (5)(8)(9) Developing algorithms and software to improve visualization of data for life science and healthcare applications		Life Sciences			
Series Seed Convertible Preferred Stock	(I)		1,250,000	4,194,630	1,312,425
Ensemble Therapeutics Corporation (5)(8) Developing DNA-Programmed Chemistry™ for the discovery of new classes of therapeutics		Life Sciences			
Series B Convertible Preferred Stock	(I)		2,000,000	1,449,275	1,060,023
Series B-1 Convertible Preferred Stock	(I)		679,754	492,575	1,833,862
			2,679,754		2,893,885
HZO, Inc. (5)(8)(9) Developing novel industrial coatings that protect electronics against damage from liquids		Electronics			
Common Stock	(I)		666,667	405,729	322,832
Series I Convertible Preferred Stock	(I)		5,709,835	2,266,894	4,482,097

Series II Convertible Preferred Stock	( I )	2,000,003	539,710	2,113,002
		8,376,505		6,917,931

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 61.0% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (14) – 53.3% of net assets at value (Cont.)					
Laser Light Engines, Inc. (5)(8)		Energy			
Manufactured solid-state light sources for digital cinema and large-venue projection displays					
Series A Convertible Preferred Stock	(M)		\$2,000,000	7,499,062	\$0
Series B Convertible Preferred Stock	(M)		3,095,802	13,571,848	0
Secured Convertible Bridge Note, 12%, acquired 10/7/11	(M)		200,000	\$200,000	0
Secured Convertible Bridge Note, 12%, acquired 11/17/11	(M)		95,652	\$95,652	0
Secured Convertible Bridge Note, 12%, acquired 12/21/11	(M)		82,609	\$82,609	0
Secured Convertible Bridge Note, 12%, acquired 3/5/12	(M)		434,784	\$434,784	0
Secured Convertible Bridge Note, 12%, acquired 7/26/12	(M)		186,955	\$186,955	0
Secured Convertible Bridge Note, 20%, acquired 4/29/13	(M)		166,667	\$166,667	0
Secured Convertible Bridge Note, 20%, acquired 7/22/13	(M)		166,667	\$166,667	0
Secured Convertible Bridge Note, 10%, acquired 10/30/13	(M)		80,669	\$80,669	0
Secured Convertible Bridge Note, 10%, acquired 2/5/14	(M)		19,331	\$19,331	0
Secured Convertible Bridge Note, 10%, acquired 6/24/14	(M)		13,745	\$13,745	0
			6,542,881		0
Metabolon, Inc. (5)(8)(9)		Life Sciences			
Developing service and diagnostic products through the use of a metabolomics, or biochemical, profiling platform					
Series B Convertible Preferred Stock	(H)		2,500,000	371,739	2,781,374

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

Series B-1 Convertible Preferred Stock	(H)	706,214	148,696	1,158,654
Series C Convertible Preferred Stock	(H)	1,000,000	1,000,000	2,535,525
Series D Convertible Preferred Stock	(H)	1,499,999	835,882	2,179,624
Series E Convertible Preferred Stock	(H)	1,225,000	444,404	1,556,847
Warrants for Series B-1 Convertible Preferred Stock expiring 3/25/15	(I)	293,786	74,348	484,535
		7,224,999		10,696,559

OpGen, Inc. (8)(19)

Life  
Sciences

Developing tools for genomic sequence assembly and analysis

Series A Convertible Preferred Stock	(H)	610,017	610,017	606,252
Common Stock	(H)	3,260,000	29,883	22,752
Secured Convertible Bridge Note, 8%, acquired 7/11/14	(H)	216,991	\$209,020	273,908
Secured Convertible Bridge Note, 8%, acquired 10/16/14	(H)	254,278	\$250,000	256,571
Secured Convertible Bridge Note, 8%, acquired 11/14/14	(H)	202,133	\$200,000	203,633
Secured Convertible Bridge Note, 8%, acquired 12/29/14	(H)	100,067	\$100,000	100,561
		4,643,486		1,463,677

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



## HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 61.0% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (14) – 53.3% of net assets at value (Cont.)					
Produced Water Absorbents, Inc. (5)(8)		Energy			
Developing nano-structured absorbent materials for environmental remediation of contaminated water in the oil and gas industries					
Series A Convertible Preferred Stock	(M)		\$1,000,000	1,000,000	\$300,215
Series B Convertible Preferred Stock	(M)		1,496,865	5,987,460	2,188,272
Series B-2 Convertible Preferred Stock	(M)		1,015,427	4,322,709	1,579,844
Series B-3 Convertible Preferred Stock	(M)		978,641	3,914,564	1,430,677
Series C Convertible Preferred Stock	(M)		1,000,268	2,667,380	755,130
Subordinated Secured Debt, 12%, maturing on 6/30/15	(M)		979,253	\$1,000,000	979,450
Warrants for Series B-2 Preferred Stock expiring upon liquidation event	(I)		65,250	300,000	44,014
			6,535,704		7,277,602
SiOnyx, Inc. (5)(8)		Electronics			
Developing silicon-based optoelectronic products enabled by its proprietary Black Silicon					
Series A Convertible Preferred Stock	(I)		750,000	233,499	0
Series A-1 Convertible Preferred Stock	(I)		890,000	2,966,667	0
Series A-2 Convertible Preferred Stock	(I)		2,445,000	4,207,537	0
Series B-1 Convertible Preferred Stock	(I)		1,169,561	1,892,836	0
Series C Convertible Preferred Stock	(I)		1,171,316	1,674,030	0
Secured Convertible Bridge Note, 8%, acquired 1/31/14	(I)		1,281,125	\$1,281,125	0
Secured Convertible Bridge Note, 8%, acquired 5/9/14	(I)		76,966	\$93,976	0
Secured Convertible Bridge Note, 10%, acquired 12/12/14	(I)		69,382	\$68,999	161,285
Warrants for Series B-1 Convertible Preferred Stock expiring 2/23/17	(I)		130,439	247,350	0

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

Warrants for Common Stock expiring 3/28/17	(I)	84,207	418,507	0
Warrants for Common Stock expiring 5/9/19	(I)	17,010	3,208	0
		8,085,006		161,285

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 61.0% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (14) – 53.3% of net assets at value (Cont.)					
Ultora, Inc. (5)(8)		Energy			
Developing energy-storage devices enabled by carbon nanotubes					
Series A Convertible Preferred Stock	(I)		\$886,830	17,736	\$0
Series B Convertible Preferred Stock	(I)		236,603	2,347,254	0
Secured Convertible Bridge Note, 5%, acquired 5/7/14	(I)		86,039	\$86,039	0
Secured Convertible Bridge Note, 5%, acquired 8/20/14	(I)		17,208	\$17,208	0
Secured Convertible Bridge Note, 5%, acquired 10/14/14	(I)		10,750	\$10,750	0
			1,237,430		0
Total Non-Controlled Private Placement Portfolio (cost: \$67,236,533)					\$58,470,864
Publicly Traded Portfolio (20) – 7.7% of net assets at value					
Enumeral Biomedical Holdings, Inc. (5)(21)		Life Sciences			
Developing therapeutics and diagnostics through functional assaying of single cells					
Common Stock	(M)		\$4,993,357	7,966,368	\$7,251,178
Warrants for Common Stock expiring 7/30/19	(I)		540,375	1,500,000	874,594
Warrants for Common Stock expiring 2/2/24	(I)		57,567	255,120	208,179
Options to Purchase Common Stock at \$1.00 expiring 8/4/24	(I)		0	56,667	50,690
			5,591,299		8,384,641
Total Non-Controlled Publicly Traded Portfolio (cost: \$5,591,299)					\$8,384,641

Total Investments in Non-Controlled Affiliated Companies (cost: \$72,827,832)	\$66,855,505
--	--------------

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (3) – 4.1% of net assets at value					
Private Placement Portfolio (Illiquid) (22) – 4.1% of net assets at value					
ProMuc, Inc. (5)(8)		Life Sciences			
Developing synthetic mucins for the nutritional, food and healthcare markets					
Common Stock	(M)		\$1	1,000	\$1
Secured Convertible Bridge Note, 8%, acquired 12/18/13	(M)		379,074	\$350,000	379,074
Secured Convertible Bridge Note, 8%, acquired 8/13/14	(M)		103,090	\$100,000	103,090
			482,165		482,165
Senova Systems, Inc. (5)(8)		Life Sciences			
Developing next-generation sensors to measure pH					
Series B Convertible Preferred Stock	(I)		1,218,462	1,350,000	403,123
Series B-1 Convertible Preferred Stock	(I)		1,083,960	2,759,902	899,187
Series C Convertible Preferred Stock	(I)		608,287	811,049	609,349
Warrants for Series B Preferred Stock expiring 10/15/17	(I)		131,538	164,423	49,098
Warrants for Series B Preferred Stock expiring 4/24/18	(I)		20,000	25,000	7,465
			3,062,247		1,968,222
SynGlyco, Inc. (5)(8)		Life Sciences			
Developed synthetic carbohydrates for pharmaceutical applications					
Common Stock	(I)		2,729,817	57,463	0
Series A' Convertible Preferred Stock	(I)		4,855,627	4,855,627	0
Senior Secured Debt, 12.00%, maturing on 12/11/14	(I)		424,101	\$500,000	820,119
Secured Convertible Bridge Note, 8%, acquired 1/23/13	(I)		406,417	\$350,000	204,763
Secured Convertible Bridge Note, 8%, acquired 4/25/13	(I)		341,825	\$300,000	172,220

		8,757,787		1,197,102
TARA Biosystems, Inc. (5)(8)(15)			Life Sciences	
Developing human tissue models for toxicology and drug discovery applications				
Common Stock	(M)	20	2,000,000	20
Secured Convertible Bridge Note, 8%, acquired 8/20/14	(M)	308,811	\$300,000	308,811
		308,831		308,831

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (3) – 4.1% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (22) – 4.1% of net assets at value (Cont.)					
UberSeq, Inc. (5)(8)(9)(15) Developing translational genomics solutions Series Seed Convertible Preferred Stock (1)		Life Sciences	\$500,000	500,000	\$506,159
Total Controlled Private Placement Portfolio (cost: \$13,111,030)					\$4,462,479
Total Investments in Controlled Affiliated Companies (cost: \$13,111,030)					\$4,462,479
Total Private Placement and Publicly Traded Portfolio (cost: \$112,371,315)					\$89,764,840
Total Investments (cost: \$112,371,315)					\$89,764,840

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

Notes to Consolidated Schedule of Investments

(1) See "Footnote to Consolidated Schedule of Investments" on page 132 for a description of the "Valuation Procedures."

We classify "Energy" companies as those that seek to improve performance, productivity or efficiency, and to reduce environmental impact, waste, cost, energy consumption or raw materials. We classify "Electronics" companies as those that address problems in electronics-related industries, including semiconductors. We classify (2) "Life Sciences" companies as those that address problems in life sciences-related industries, including biotechnology, agriculture, advanced materials and chemicals, healthcare, bioprocessing, water, industrial biotechnology, food, nutrition and energy.

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 (3) which we own five percent or more, but less than 25 percent, of the voting shares of the portfolio company, or where we hold one or more seats on the portfolio company's board of directors but do not control the company. Investments in controlled affiliated companies consist of investments in which we own 25 percent or more of the voting shares of the portfolio company or otherwise control the company.

The aggregate cost for federal income tax purposes of investments in unaffiliated privately held companies is (4) \$22,304,047. The gross unrealized appreciation based on the tax cost for these securities is \$7,872. The gross unrealized depreciation based on the tax cost for these securities is \$8,457,013.

(5) All or a portion of the investments or instruments are pledged as collateral under our Loan Facility.

The aggregate cost for federal income tax purposes of investments in unaffiliated rights to milestone payments is (6) \$2,387,278. The gross unrealized appreciation based on the tax cost for these securities is \$807,309. The gross unrealized depreciation based on the tax cost for these securities is \$722.

The aggregate cost for federal income tax purposes of investments in unaffiliated publicly traded companies is (7) \$1,741,128. The gross unrealized appreciation based on the tax cost for these securities is \$10,901. The gross unrealized depreciation based on the tax cost for these securities is \$353,944.



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

(9) Represents a non-income producing security. Investments that have not paid dividends or interest within the last 12 months are considered to be non-income producing.

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

(11) On March 11, 2015, we submitted notice to exercise our put option for our remaining warrants of GEO Semiconductor, Inc.

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2014

With our investment in the Mersana Therapeutics, Inc., Series A-1 financing, we received a warrant to purchase 277,760 shares of Series A-2 Convertible Preferred Stock. The ability to exercise the warrant is contingent upon (12) Mersana's achievement of certain milestones. Mersana has not achieved those milestones as of December 31, 2014, and, therefore, this warrant is a contingent asset as of that date. In January 2015, the holders of these warrants, including the Company, elected to cancel them owing to the milestones being impossible to achieve.

Upon the closing of Canon, Inc.'s acquisition of Molecular Imprints, Inc.'s semiconductor lithography equipment (13) business, a new spin-out company, which retained the name Molecular Imprints, Inc., was formed. These shares represent our investment in the new company.

The aggregate cost for federal income tax purposes of investments in non-controlled affiliated privately held (14) companies is \$67,236,533. The gross unrealized appreciation based on the tax cost for these securities is \$11,846,184. The gross unrealized depreciation based on the tax cost for these securities is \$20,611,853.

(15) Initial investment was made in 2014.

(16) As part of our initial investment in Accelerator IV-New York Corporation, the Company made an additional operating and investment commitment. See "Note 11. Commitments and Contingencies."

(17) Adesto Technologies Corporation's Series E shares have certain rights and preferences in a sale or IPO that are not ascribed to the other classes of stock.

D-Wave Systems, Inc., is located and is doing business primarily in Canada. We invested in D-Wave through Parallel Universes, Inc., a Delaware company. Our investment is denominated in Canadian dollars and is subject (18) to foreign currency translation. See "Note 2. Summary of Significant Accounting Policies." D-Wave is not a qualifying asset under Section 55(a) of the 1940 Act. Under the 1940 Act, we may not acquire non-qualifying assets unless, at the time the acquisition is made, qualifying assets are at least 70 percent of our total assets.

(19) On March 3, 2015, OpGen, Inc., filed a registration statement on Form S-1 to seek an IPO. There can be no assurances if or when such IPO will occur or if it will be successful.

The aggregate cost for federal income tax purposes of investments in non-controlled affiliated publicly traded (20) companies is \$5,591,299. The gross unrealized appreciation based on the tax cost for these securities is \$2,793,342. The gross unrealized depreciation based on the tax cost for these securities is \$0.

(21) The Company's shares of Enumeral Biomedical Holdings, Inc., are subject to restrictions on transfer, and we are also subject to a lock-up agreement that restricts our ability to trade these shares, exclusive of the general restriction on the transfer of unregistered securities. The lock-up period on our 7,966,368 shares of Enumeral Biomedical Holdings expires on January 31, 2016.

(22) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$13,111,030. The gross unrealized appreciation based on the tax cost for these securities is \$6,159. The gross unrealized depreciation based on the tax cost for these securities is \$8,654,710.

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 31.2% of net assets at value					
Private Placement Portfolio (Illiquid) (4) – 23.8% of net assets at value					
Bridgelux, Inc. (5)(8)(10) Manufacturing high-power light emitting diodes (LEDs) and arrays		Energy			
Series B Convertible Preferred Stock	(M)		\$1,000,000	1,861,504	\$318,898
Series C Convertible Preferred Stock	(M)		1,352,196	2,130,699	365,014
Series D Convertible Preferred Stock	(M)		1,371,622	999,999	1,070,897
Series E Convertible Preferred Stock	(M)		672,599	440,334	704,760
Series E-1 Convertible Preferred Stock	(M)		386,073	399,579	468,606
Warrants for Series C Convertible Preferred Stock expiring 12/31/14	(I)		168,270	163,900	2,762
Warrants for Series D Convertible Preferred Stock expiring 8/26/14	(I)		88,531	124,999	40,686
Warrants for Series D Convertible Preferred Stock expiring 3/10/15	(I)		40,012	41,666	19,466
Warrants for Series E Convertible Preferred Stock expiring 12/31/17	(I)		93,969	170,823	190,679
Warrants for Common Stock expiring 6/1/16	(I)		72,668	132,100	1,656
Warrants for Common Stock expiring 8/9/18	(I)		148,409	171,183	13,538
Warrants for Common Stock expiring 10/21/18	(I)		18,816	84,846	3,680
			5,413,165		3,200,642
Cambrios Technologies Corporation (5)(8)(10) Developing nanowire-enabled electronic materials for the display industry		Electronics			
Series B Convertible Preferred Stock	(M)		1,294,025	1,294,025	1,165,383
Series C Convertible Preferred Stock	(M)		1,300,000	1,300,000	1,170,764
Series D Convertible Preferred Stock	(M)		515,756	515,756	773,634
Series D-2 Convertible Preferred Stock	(M)		92,400	92,400	92,400
Series D-4 Convertible Preferred Stock	(M)		216,168	216,168	216,168
			3,418,349		3,418,349
Cobalt Technologies, Inc. (5)(8)(9)(11) Developing processes for making bio- butanol through biomass fermentation		Energy			

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

Series C-1 Convertible Preferred Stock	(M)	749,998	352,112	704,400
Series D-1 Convertible Preferred Stock	(M)	122,070	48,828	106,152
Series E-1 Convertible Preferred Stock	(M)	114,938	46,089	84,634
Warrants for Series E-1 Pref. Stock expiring on 10/9/22	(I)	2,781	1,407	2,163
Warrants for Series E-1 Pref. Stock expiring on 3/11/23	(I)	5,355	2,707	4,209
		995,142		901,558

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

HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 31.2% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) – 23.8% of net assets at value (Cont.)					
Ensemble Therapeutics Corporation (5)(8)(9)(12)		Life Sciences			
Developing DNA-Programmed Chemistry™ for the discovery of new classes of therapeutics					
Series B Convertible Preferred Stock	(H)		\$2,000,000	1,449,275	\$1,419,855
Secured Convertible Bridge Note, 8%, acquired 9/11/08	(H)		356,567	\$250,211	1,321,657
Secured Convertible Bridge Note, 8%, acquired 12/10/09	(H)		64,767	\$48,868	253,257
Secured Convertible Bridge Note, 8%, acquired 1/25/12	(H)		126,386	\$109,400	548,354
Secured Convertible Bridge Note, 8%, acquired 3/28/13	(H)		78,121	\$73,598	361,996
Secured Convertible Bridge Note, 8%, acquired 6/24/13	(H)		26,845	\$25,759	126,201
Secured Convertible Bridge Note, 8%, acquired 7/8/13	(H)		14,530	\$13,983	68,467
			2,667,216		4,099,787
GEO Semiconductor Inc. (5)		Electronics			
Developing programmable, high-performance video and geometry processing solutions					
Participation Agreement with Montage Capital relating to the following assets:					
Warrants for Series A Pref. Stock expiring on 9/17/17	(I)		66,684	100,000	82,270
Warrants for Series A-1 Pref. Stock expiring on 6/30/18	(I)		23,566	34,500	32,132
Loan and Security Agreement with GEO Semiconductor relating to the following assets:					
Warrants for Series A Pref. Stock expiring on 3/1/18	(I)		7,512	10,000	8,007
	(I)		7,546	10,000	8,478

Warrants for Series A-1 Pref. Stock expiring on  
6/29/18

		105,308		130,887
Mersana Therapeutics, Inc. (5)(8)(9)(10)(13)				
Developing antibody drug conjugates for cancer therapy				
Series A-1 Convertible Preferred Stock	(M)	443,038	411,630	443,038
Common Stock	(M)	3,875,395	350,539	108,667
		4,318,433		551,705
Molecular Imprints, Inc. (5)(8)(10)(14)(15)				
Manufacturing nanoimprint lithography capital equipment				
Series B Convertible Preferred Stock	(I)	2,000,000	1,333,333	1,876,501
Series C Convertible Preferred Stock	(I)	2,406,595	1,285,071	2,359,061
Non-Convertible Bridge Note	(I)	0	\$0	4,043,381
		4,406,595		8,278,943

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 31.2% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) – 23.8% of net assets at value (Cont.)					
Nanosys, Inc. (5)(8)		Energy			
Developing inorganic nanowires and quantum dots for use in LED-backlit devices					
Series C Convertible Preferred Stock	(M)		\$ 1,500,000	803,428	\$ 1,098,762
Series D Convertible Preferred Stock	(M)		3,000,003	1,016,950	2,196,781
Series E Convertible Preferred Stock	(M)		496,573	433,688	705,827
Unsecured Convertible Bridge Note, 4%, acquired 7/16/12	(M)		46,385	\$43,821	127,016
			5,042,961		4,128,386
Nano Terra, Inc. (5)(9)		Energy			
Developing surface chemistry and nano- manufacturing solutions					
Senior secured debt, 12.0%, maturing on 12/1/15	(I)		663,322	\$ 698,725	680,000
Warrants for Series A-2 Pref. Stock expiring on 2/22/21	(I)		69,168	446,248	21,858
Warrants for Series C Pref. Stock expiring on 11/15/22	(I)		35,403	241,662	90,476
			767,893		792,334
Nantero, Inc. (5)(8)(9)(10)		Electronics			
Developing a high-density, nonvolatile, random access memory chip, enabled by carbon nanotubes					
Series A Convertible Preferred Stock	(M)		489,999	345,070	1,349,224
Series B Convertible Preferred Stock	(M)		323,000	207,051	809,569
Series C Convertible Preferred Stock	(M)		571,329	188,315	736,312
Series D Convertible Preferred Stock	(M)		139,075	35,569	139,075
			1,523,403		3,034,180
OHSO Clean, Inc. (5)(16)		Life Sciences			



Developing natural, hypoallergenic household cleaning products enabled by nanotechnology-enabled formulations of thyme oil

Participation Agreement with Montage

Capital relating to the following assets:

Senior secured debt, 13.00%, maturing on 3/31/15	( I )	527,006	\$ 624,640	592,100
Warrants for Series C Pref. Stock expiring on 3/30/22	( I )	91,742	1,109,333	70,693
		618,748		662,793
Total Unaffiliated Private Placement Portfolio (cost: \$29,277,213)				\$29,199,564

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

## HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Rights to Milestone Payments (Illiquid) (6) – 2.9% of net assets at value					
Amgen, Inc. (8)(10)		Life Sciences			
Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	(I)		\$3,291,750	\$3,291,750	\$3,489,433
Laird Technologies, Inc. (8)(10)		Energy			
Rights to Milestone Payments from Merger & Acquisition of Nextreme Thermal Solutions, Inc.	(I)		0	0	0
Total Unaffiliated Rights to Milestone Payments (cost: \$3,291,750)					\$3,489,433
Publicly Traded Portfolio (7) – 4.5% of net assets at value					
Solazyme, Inc. (5)(10)(17)		Energy			
Developing algal biodiesel, industrial chemicals and specialty ingredients using synthetic biology					
Common Stock	(M)		\$396,564	167,834	\$1,827,712
Champions Oncology, Inc. (5)(10)		Life Sciences			
Developing its TumorGraft™ platform for personalized medicine and drug development					
Common Stock	(M)		2,054,446	3,099,651	3,719,582
Warrants for Common Stock expiring 1/29/18	(I)		400	40,000	23,502
			2,054,846		3,743,084
Total Unaffiliated Publicly Traded Portfolio (cost: \$2,451,410)					\$5,570,796
Total Investments in Unaffiliated Companies (cost: \$35,020,373)					\$38,259,793

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



## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 44.2% of net assets at value					
Private Placement Portfolio (Illiquid) (18) – 44.2% of net assets at value					
ABSMaterials, Inc. (5)(8)(9) Developing nano-structured absorbent materials for environmental remediation	(M)	Energy	\$435,000	390,000	\$471,900
Series A Convertible Preferred Stock					
Series B Convertible Preferred Stock	(M)		717,644	624,528	755,679
			1,152,644		1,227,579
Adesto Technologies Corporation (5)(8)(19) Developing low-power, high-performance memory devices					
Series A Convertible Preferred Stock	(M)	Electronics	2,200,000	6,547,619	1,388,276
Series B Convertible Preferred Stock	(M)		2,200,000	5,952,381	1,262,070
Series C Convertible Preferred Stock	(M)		1,485,531	2,122,187	449,963
Series D Convertible Preferred Stock	(M)		1,393,147	1,466,470	1,070,067
Series D-1 Convertible Preferred Stock	(M)		703,740	987,706	561,291
Series E Convertible Preferred Stock	(M)		2,499,999	3,508,771	9,969,781
			10,482,417		14,701,448
AgBiome, LLC (formerly AgInnovation, LLC) (5)(8)(9)(10)(20) Providing early stage research and discovery for agriculture and utilizing the crop microbiome to identify products that reduce risk and improve yield					
Series A-1 Convertible Preferred Stock	(M)	Life Sciences	2,000,000	2,000,000	2,456,834
Series A-2 Convertible Preferred Stock	(M)		521,740	417,392	564,906
			2,521,740		3,021,740
Contour Energy Systems, Inc. (5)(8)(9)(10)(21)					
		Energy			

Developing batteries using  
nano-structured materials

Series A Convertible Preferred Stock	(M)	2,009,995	2,565,798	0
Series B Convertible Preferred Stock	(M)	1,300,000	812,500	0
Series C Convertible Preferred Stock	(M)	1,200,000	1,148,325	90,844
		4,509,995		90,844

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 44.2% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (18) – 44.2% of net assets at value (Cont.)					
D-Wave Systems, Inc. (8)(9)(10)(22)		Electronics			
Developing high-performance quantum computing systems					
Series 1 Class B Convertible Preferred Stock	(M)		\$1,002,074	1,144,869	\$1,399,831
Series 1 Class C Convertible Preferred Stock	(M)		487,804	450,450	550,765
Series 1 Class D Convertible Preferred Stock	(M)		748,473	855,131	1,045,569
Series 1 Class E Convertible Preferred Stock	(M)		248,049	269,280	329,249
Series 1 Class F Convertible Preferred Stock	(M)		238,323	258,721	316,338
Series 2 Class D Convertible Preferred Stock	(M)		736,019	678,264	829,313
Series 2 Class E Convertible Preferred Stock	(M)		659,493	513,900	628,345
Series 2 Class F Convertible Preferred Stock	(M)		633,631	493,747	603,704
Warrants for Common Stock expiring 6/30/15	(I)		98,644	153,890	37,617
			4,852,510		5,740,731
EchoPixel, Inc. (5)(8)(9)(10)(23)		Life Sciences			
Developing algorithms and software to improve visualization of data for life science and healthcare applications					
Series Seed Convertible Preferred Stock	(M)		750,000	2,516,778	750,000
Enumeral Biomedical Corp. (5)(8)(9)(10)		Life Sciences			
Developing therapeutics and diagnostics through functional assaying of single cells					
Series A Convertible Preferred Stock	(M)		1,026,832	957,038	690,538
Series A-1 Convertible Preferred Stock	(M)		750,000	576,923	425,939
Series A-2 Convertible Preferred Stock	(M)		1,050,001	724,138	566,027
			2,826,833		1,682,504
H2O, Inc. (5)(8)(9)		Electronics			
Developing novel industrial coatings that protect electronics against damage from liquids					
Series A Convertible Preferred Stock	(M)		666,667	4,057,294	1,130,362
Series B Convertible Preferred Stock	(M)		5,502,838	21,879,365	6,095,592

6,169,505

7,225,954

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 44.2% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (18) – 44.2% of net assets at value (Cont.)					
Kovio, Inc. (5)(8)(9)(24)		Electronics			
Developing semiconductor products using printed electronics and thin-film technologies					
Series A' Convertible Preferred Stock	(M)		\$5,242,993	2,160,000	\$0
Series B' Convertible Preferred Stock	(M)		2,006,540	3,015,493	0
Secured Subordinated Convertible Bridge Note, 7%, acquired 6/7/13	(M)		50,000	\$50,000	0
			7,299,533		0
Laser Light Engines, Inc. (5)(8)(9)		Energy			
Manufacturing solid-state light sources for digital cinema and large-venue projection displays					
Series A Convertible Preferred Stock	(I)		2,000,000	7,499,062	0
Series B Convertible Preferred Stock	(I)		3,095,802	13,571,848	0
Secured Convertible Bridge Note, 12%, acquired 10/7/11	(I)		200,000	\$200,000	0
Secured Convertible Bridge Note, 12%, acquired 11/17/11	(I)		95,652	\$95,652	0
Secured Convertible Bridge Note, 12%, acquired 12/21/11	(I)		82,609	\$82,609	0
Secured Convertible Bridge Note, 12%, acquired 3/5/12	(I)		434,784	\$434,784	0
Secured Convertible Bridge Note, 12%, acquired 7/26/12	(I)		186,955	\$186,955	0
Secured Convertible Bridge Note, 20%, acquired 4/29/13	(I)		166,667	\$166,667	0
Secured Convertible Bridge Note, 20%, acquired 7/22/13	(I)		166,667	\$166,667	0
Secured Convertible Bridge Note, 10%, acquired 10/30/13	(I)		82,061	\$80,669	164,122
			6,511,197		164,122



Metabolon, Inc. (5)(8)(10)					Life Sciences
Developing service and diagnostic products through the use of a metabolomics, or biochemical, profiling platform					
Series B Convertible Preferred Stock	(M)	2,500,000	371,739	2,997,991	
Series B-1 Convertible Preferred Stock	(M)	706,214	148,696	1,199,196	
Series C Convertible Preferred Stock	(M)	1,000,000	1,000,000	2,756,500	
Series D Convertible Preferred Stock	(M)	1,499,999	835,882	2,304,109	
Series E Convertible Preferred Stock	(M)	1,225,000	444,404	1,225,000	
Warrants for Series B-1 Convertible Preferred Stock expiring 3/25/15	( I )	293,786	74,348	216,408	
		7,224,999		10,699,204	
OpGen, Inc. (8)					Life Sciences
Developing tools for genomic sequence assembly and analysis					
Series A Convertible Preferred Stock	(M)	245,000	245,000	245,000	
Common Stock	(M)	3,260,000	29,883	0	
		3,505,000		245,000	

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

## HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 44.2% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (18) – 44.2% of net assets at value (Cont.)					
Produced Water Absorbents, Inc. (5)(8)(9) Developing nano-structured absorbent materials for environmental remediation of contaminated water in the oil and gas industries		Energy			
Series A Convertible Preferred Stock	(M)		\$1,000,000	1,000,000	\$125,000
Series B Convertible Preferred Stock	(M)		1,626,641	6,506,564	1,751,641
Secured Convertible Bridge Note, 8%, acquired 11/14/13	(M)		832,789	\$824,119	832,789
			3,459,430		2,709,430
Senova Systems, Inc. (5)(8)(9) Developing next-generation sensors to measure pH		Life Sciences			
Series B Convertible Preferred Stock	(M)		1,218,462	1,350,000	540,000
Series B-1 Convertible Preferred Stock	(M)		583,960	1,509,902	603,960
Warrants for Series B Preferred Stock expiring 10/15/17	(I)		131,538	164,423	65,753
Warrants for Series B Preferred Stock expiring 4/24/18	(I)		20,000	25,000	9,997
			1,953,960		1,219,710
SiOnyx, Inc. (5)(8)(9) Developing silicon-based optoelectronic products enabled by its proprietary Black Silicon		Electronics			
Series A Convertible Preferred Stock	(M)		750,000	233,499	43,781
Series A-1 Convertible Preferred Stock	(M)		890,000	2,966,667	556,250
Series A-2 Convertible Preferred Stock	(M)		2,445,000	4,207,537	788,913
Series B-1 Convertible Preferred Stock	(M)		1,169,561	1,892,836	451,903
Series C Convertible Preferred Stock	(M)		1,171,316	1,674,030	970,526
	(M)		433,209	\$418,066	859,729

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

Secured Convertible Bridge Note, 8%, acquired 7/22/13				
Secured Convertible Bridge Note, 8%, acquired 10/2/13	(M)	426,520	\$418,066	859,729
Warrants for Series B-1 Convertible Preferred Stock expiring 2/23/17	(I)	130,439	247,350	18,165
Warrants for Common Stock expiring 3/28/17	(I)	84,207	418,507	21,387
		7,500,252		4,570,383
Ultora, Inc. (5)(8)(9)				
			Energy	
Developing energy-storage devices enabled by carbon nanotubes	(M)	886,830	17,736	1,788
Series A Convertible Preferred Stock				
Series B Convertible Preferred Stock	(M)	236,603	2,347,254	236,603
		1,123,433		238,391
Total Non-Controlled Private Placement Portfolio (cost: \$71,843,448)				\$54,287,040
Total Investments in Non-Controlled Affiliated Companies (cost: \$71,843,448)				\$54,287,040

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (3) – 1.1% of net assets at value					
Private Placement Portfolio (Illiquid) (25) – 1.1% of net assets at value					
SynGlyco, Inc. (5)(8)(9)(26)					
Developing synthetic carbohydrates for pharmaceutical applications					
Life Sciences					
Common Stock	(I)		\$2,729,817	57,463	\$0
Series A' Convertible Preferred Stock	(I)		4,855,627	4,855,627	0
Senior Secured Debt, 12.00%, maturing on 12/11/14	(I)		436,637	\$500,000	831,828
Secured Convertible Bridge Note, 8%, acquired 1/23/13	(I)		376,312	\$350,000	91,389
Secured Convertible Bridge Note, 8%, acquired 4/25/13	(I)		316,504	\$300,000	78,334
			8,714,897		1,001,551
ProMuc, Inc. (5)(8)(9)(22)					
Developing synthetic mucins for the nutritional, food and healthcare markets					
Life Sciences					
Common Stock	(M)		1	1,000	1
Secured Convertible Bridge Note, 8%, acquired 12/18/13	(M)		351,074	\$350,000	351,074
			351,075		351,075
Total Controlled Private Placement Portfolio (cost: \$9,065,972)					\$1,352,626
Total Investments in Controlled Affiliated Companies (cost: \$9,065,972)					\$1,352,626
Total Private Placement and Publicly Traded Portfolio (cost: \$115,929,793)					\$93,899,459

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

## HARRIS &amp; HARRIS GROUP, INC.

## CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

	Method of Valuation (1)	Cost	Shares/ Principal	Value
U.S. Government Securities (27) – 15.5% of net assets at value				
U.S. Treasury Bill — due date 01/23/14	(M)	\$18,999,765	\$19,000,000	\$18,999,810
Total Investments in U.S. Government Securities (cost: \$18,999,765)				\$18,999,810
Total Investments (cost: \$134,929,558)				\$112,899,269

	Method of Valuation (1)	Number of Contracts	Value
Written Call Options (22) – (0.1)% of net assets at value			
Solazyme, Inc. — Strike Price \$12.50, March 22, 2014	(M)	1,500	103,500
Total Written Call Options (Premiums Received \$112,382)			\$(103,500)

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

Notes to Consolidated Schedule of Investments

- (1) See "Footnote to Consolidated Schedule of Investments" on page 132 for a description of the "Valuation Procedures."

We classify "Energy" companies as those that seek to improve performance, productivity or efficiency, and to reduce environmental impact, waste, cost, energy consumption or raw materials. We classify "Electronics" companies as those that address problems in electronics-related industries, including semiconductors. We classify "Life Sciences" companies as those that address problems in life sciences-related industries, including biotechnology, agriculture, advanced materials and chemicals, healthcare, bioprocessing, water, industrial biotechnology, food, nutrition and energy.

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

The aggregate cost for federal income tax purposes of investments in unaffiliated privately held companies is \$29,277,213. The gross unrealized appreciation based on the tax cost for these securities is \$6,909,761. The gross unrealized depreciation based on the tax cost for these securities is \$6,987,410.

All or a portion of the investments or instruments are pledged as collateral under our Loan Facility.

The aggregate cost for federal income tax purposes of investments in unaffiliated rights to milestone payments is \$3,291,750. The gross unrealized appreciation based on the tax cost for these securities is \$197,683. The gross unrealized depreciation based on the tax cost for these securities is \$0.

The aggregate cost for federal income tax purposes of investments in unaffiliated publicly traded companies is \$2,451,410. The gross unrealized appreciation based on the tax cost for these securities is \$3,119,386. The gross unrealized depreciation based on the tax cost for these securities is \$0.

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

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

(10) Represents a non-income producing security. Investments that have not paid dividends or interest within the last 12 months are considered to be non-income producing.

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

With our investments in convertible bridge notes issued by Ensemble Therapeutics Corporation, we received warrants to purchase a number of shares of the class of stock sold in the next financing of Ensemble Therapeutics Corporation equal to \$260,989 divided by the price per share of the class of stock sold in the next financing of Ensemble Therapeutics Corporation. The ability to exercise these warrants is, therefore, contingent on Ensemble Therapeutics Corporation completing successfully a subsequent round of financing. These warrants shall expire and no longer be exercisable on dates ranging from September 10, 2015, through July 8, 2020. The cost basis of these warrants is \$157.

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



HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2013

(13) With our investment in the Mersana Therapeutics, Inc., Series A-1 financing, we received a warrant to purchase 277,760 shares of Series A-2 Convertible Preferred Stock. The ability to exercise the warrant is contingent upon Mersana's achievement of certain milestones. Mersana has not achieved those milestones as of December 31, 2013, and, therefore, this warrant is a contingent asset as of that date. The warrant will expire on July 27, 2022.

(14) As part of a loan the Company made to Molecular Imprints in the second quarter of 2011, we received a liquidation preference payable upon a sale of the company equal to three times the principal of the loan, or \$4,044,450. This preference is senior to the preferences of the outstanding preferred stock. While the loan has since been repaid, this liquidation preference remains outstanding as of December 31, 2013.

(15) On February 13, 2014, Molecular Imprints, Inc., announced that it had signed an agreement to sell its semiconductor lithography equipment business to Canon, Inc. See "Note 13. Subsequent Events."

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

(17) A portion of this security is held in connection with written call option contracts: 150,000 shares, having a fair value of \$1,633,500, have been pledged to brokers.

(18) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated privately held companies is \$71,843,448. The gross unrealized appreciation based on the tax cost for these securities is \$10,212,841. The gross unrealized depreciation based on the tax cost for these securities is \$27,769,249.

(19) Adesto Technologies Corporation's Series E shares have certain rights and preferences in a sale or IPO that are not ascribed to the other classes of stock.

(20) On January 29, 2013, AgInnovation, LLC, changed its name to AgBiome, LLC.

(21) On February 27, 2014, the board of directors of Contour Energy Systems, Inc., adopted a plan of complete liquidation and dissolution. See "Note 13. Subsequent Events."

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

(23) Initial investment was made in 2013.

(24) On January 21, 2014, substantially all of Kovio's assets were sold to Thin Film Electronics ASA. See "Note 13. Subsequent Events."

The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is (25) \$9,065,972. The gross unrealized appreciation based on the tax cost for these securities is \$0. The gross unrealized depreciation based on the tax cost for these securities is \$7,713,346.

On October 31, 2013, Ancora sold a substantial portion of its assets, including the use of its corporate name, to (26) Corden Pharma International US, Inc. ("Corden"). The remaining assets formed a new company, SynGlyco, Inc., of which we continue to own shares. SynGlyco may receive future royalty payments based upon certain sales targets and other terms of the Corden acquisition.

The aggregate cost for federal income tax purposes of our U.S. government securities is \$18,999,765. The gross (27) unrealized appreciation on the tax cost for these securities is \$45. The gross unrealized depreciation on the tax cost of these securities is \$0.

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

**HARRIS & HARRIS GROUP, INC.**

**FOOTNOTE TO CONSOLIDATED SCHEDULE OF INVESTMENTS**

**VALUATION PROCEDURES**

**I. Determination of Net Asset Value**

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

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

The Valuation Committee, comprised of all of the independent Board members, is responsible for determining the valuation of the Company's assets within the guidelines established by the Board of Directors. The Valuation Committee receives information and recommendations from management. An independent valuation firm also reviews select portfolio company valuations. The independent valuation firm does not provide proposed valuations.

The fair values assigned to these investments are based on available information and do not necessarily represent amounts that might ultimately be realized when that investment is sold, as such amounts depend on future circumstances and cannot reasonably be determined until the individual investments are actually liquidated or become readily marketable.

The deal team meets at the end of each quarter to discuss portfolio companies and propose fair valuations for all privately held securities, restricted publicly traded securities and publicly traded securities without reliable market quotations. The Valuation Committee book is prepared with the use of data from primary sources whenever reasonably practicable. Proposed valuations for each portfolio company are communicated to the Valuation Committee in the Valuation Committee book and at the Valuation Committee meeting after the end of each quarter. The Valuation Committee determines the fair value of each private security and publicly traded securities without reliable market quotations. All valuations are then reported to the full Board of Directors along with the Chief Financial Officer's calculation of net asset value.

## **II. Approaches to Determining Fair Value**

Accounting Standards Codification Topic 820, "Fair Value Measurements and Disclosures," ("ASC 820") defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). It applies fair value terminology to all valuations whereas the 1940 Act applies market value terminology to readily marketable assets and fair value terminology to other assets.

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

Market Approach (M): The market approach may use quantitative inputs such as prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities and the values of market multiples derived from a set of comparable companies. The market approach may also use qualitative inputs such as progress toward milestones, the long-term potential of the business, current and future financing requirements and the rights and preferences of certain securities versus those of other securities. The selection of the relevant inputs used to derive value under the market approach requires judgment considering factors specific to the significance and relevance of each input to deriving value.

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

Hybrid Approach (H): The hybrid approach uses elements of both the market approach and the income approach. The hybrid approach calculates values using the market and income approach, individually. The resulting values are then distributed among the share classes based on probability of exit outcomes.

Effective September 30, 2014, the Company refined its valuation methodologies under the income and hybrid approaches to include the option pricing model. The option pricing model allocates the calculated enterprise value of an investment among different classes of securities using call option methodologies, taking into account financial rights and preferences such as liquidation preferences, redemption rights and dividends. While the Company's valuation procedures had always included the option pricing model as a possible valuation technique, it had not previously been utilized. The use of the option pricing model is emerging as a preferred industry practice. This change in valuation methodology is applied on a prospective basis.

ASC Topic 820 classifies the inputs used to measure fair value by these approaches into the following hierarchy:

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2: Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 2 inputs are in those markets for which there are few transactions, the prices are not current, little public information exists or instances where prices vary substantially over time or among brokered market makers; and

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

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

### **III. Investment Categories**

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

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

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

#### **A. EQUITY-RELATED SECURITIES**

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

§ Readily available public market quotations;

§ The cost of the Company's investment;

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

§ The financial condition and operating results of the company;

§ The company's progress towards milestones;

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

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

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

§ Estimated time to exit;

§ Volatility of similar securities 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; and

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

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

## **B. LONG-TERM FIXED-INCOME SECURITIES**



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

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

· Credit quality;

· Interest rate analysis;

Quotations from broker-dealers;

Prices from independent pricing services that the Board believes are reasonably reliable; and

Reasonable price discovery procedures and data from other sources.

**C. SHORT-TERM FIXED-INCOME SECURITIES**

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

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

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

The cost of the Company's investment;

Investments in the same or substantially similar intellectual property or patents or research and development in technology or product development or offers by responsible third parties;

The results of research and development;

Product development and milestone progress;

Commercial prospects;

Term of patent;

Projected markets; and

Other subjective factors.

**E. ALL OTHER SECURITIES**

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

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

#### **IV. Frequency of Valuation**

The Valuation Committee shall value the Company's investment assets (i) as of the end of each calendar quarter at the time sufficiently far in advance of filing of the Company's reports on Form 10-Q and Form 10-K to enable preparation thereof, (ii) as of within 48 hours of pricing any common stock of the Company by the Company (exclusive of Sundays and holidays) unless the proposed sale price is at least 200 percent of any reasonable net asset value of such shares, and (iii) as of any other time requested by the Board of Directors.

#### **V. Regular Review**

The Chief Operating Officer and Chief Financial Officer shall review these Valuation Procedures on an annual basis to determine the continued appropriateness and accuracy of the methodologies used in valuing the Company's investment assets, and will report any proposed modifications to these Valuation Procedures to the Board of Directors for consideration and approval.

The Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer and the individuals responsible for preparing the Valuation Committee book shall meet quarterly before each Valuation Committee meeting to review the methodologies for the valuation of each security, and will highlight any changes to the Valuation Committee.

#### **VI. Other Assets**

Non-investment assets, such as fixtures and equipment, shall be valued using the cost approach less accumulated depreciation at rates determined by management and reviewed by the Audit Committee. Valuation of such assets is not the responsibility of the Valuation Committee.

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

Harris & Harris Group, Inc. (the "Company," "us," "our" and "we"), is a non-diversified management investment company operating as a business development company ("BDC") under the Investment Company Act of 1940 (the "1940 Act") that specializes in making investments in companies commercializing and integrating products enabled by disruptive technologies predominantly in the life sciences. We operate as an internally managed investment company whereby our officers and employees, under the general supervision of our Board of Directors, conduct our operations.

H&H Ventures Management, Inc.<sup>SM</sup> ("Ventures") is a 100 percent wholly owned subsidiary of the Company. Ventures is taxed under Subchapter C (a "C Corporation") of the Internal Revenue Code of 1986 (the "Code"). Harris Partners I, L.P., is a limited partnership and, from time to time, may be used to hold certain interests in portfolio companies. The partners of Harris Partners I, L.P., are Ventures (sole general partner) and the Company (sole limited partner). Ventures pays taxes on income generated by its operations as well as on any non-passive investment income generated by Harris Partners I, L.P. For the years ended December 31, 2014, 2013 and 2012, there was no non-passive investment income generated by Harris Partners I, L.P. Ventures, as the sole general partner, consolidates Harris Partners I, L.P. The Company consolidates its wholly owned subsidiary, Ventures, for financial reporting purposes.

### **NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

**Principles of Consolidation.** The consolidated financial statements have been prepared in accordance with GAAP and include the accounts of the Company and its wholly owned subsidiary. The Company is an investment company following accounting and reporting guidance in Accounting Standards Codification 946. In accordance with GAAP and Regulation S-X, the Company may only consolidate its interests in investment company subsidiaries and controlled operating companies whose business consists of providing services to the Company. Our wholly owned subsidiary, Ventures, is a controlled operating company that provides services to us and is, therefore, consolidated. All significant inter-company accounts and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current period presentation. Yield-enhancing fees of \$46,243 in 2013 and \$56,274 in 2012 have been separately stated on the Consolidated Statements of Operations. Rental income from sublease of \$80,000 in 2013 and \$107,586 in 2012 have also been separately stated on the Consolidated Statements of Operations. These amounts were previously included in Miscellaneous income in prior years' consolidated financial statements.



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

Portfolio Investment Valuations. Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the Securities and Exchange Commission ("SEC") and in accordance with GAAP. Value, as defined in Section 2(a)(41) of the 1940 Act, is (i) the market price for those securities for which a market quotation is readily available and (ii) the fair value as determined in good faith by, or under the direction of, the Board of Directors for all other assets. (See "Valuation Procedures" in the "Footnote to Consolidated Schedule of Investments.") As of December 31, 2014, our financial statements include venture capital investments valued at \$88,374,145, the fair values of which were determined in good faith by, or under the direction of, the Board of Directors. This amount includes the fair values of our privately held investments as well as the warrants of Champions Oncology, Inc., and securities of Enumeral Biomedical Holdings, Inc., which are publicly traded companies. Upon sale of investments, the values that are ultimately realized may be different from what is presently estimated. The difference could be material.

Effective September 30, 2014, the Company refined its valuation methodologies to include the option pricing model. While the Company's valuation procedures had always included the option pricing model as a possible valuation technique, it had not previously been utilized. The use of the option pricing model is emerging as a preferred industry practice. This change in valuation methodology is applied on a prospective basis.

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

Unaffiliated Rights to Milestone Payments. At December 31, 2014, and December 31, 2013, the outstanding potential milestone payments from Amgen, Inc.'s acquisition of BioVex Group, Inc., were valued at \$2,564,917 and \$3,489,433, respectively. The milestone payments are derivatives and valued using the probability-adjusted, present value of proceeds from future payments that would be due upon successful completion of certain regulatory and sales milestones. On November 17, 2014, the Company received a payment of \$2,070,955 owing to the achievement of the first milestone. If all the remaining milestones are met, we would receive \$7,455,438. There can be no assurance as to how much of this amount we will ultimately realize or when it will be realized, if at all. At December 31, 2014, the outstanding potential milestone payments from Canon, Inc.'s acquisition of Molecular Imprints, Inc., were valued at \$628,948. If all the remaining milestones are met, we would receive \$1,735,582. There can be no assurance as to how much of this amount we will ultimately realize or when it will be realized, if at all. At December 31, 2014, and December 31, 2013, the outstanding potential milestone payments from Laird Technologies, Inc.'s acquisition of Nextreme Thermal Solutions, Inc., were valued at \$0. If all the remaining milestones are met, we would receive approximately \$400,000. There can be no assurance as to how much of this amount we will ultimately realize or when it will be realized, if at all.





Receivable from Sales of Investments. At December 31, 2013, we had a receivable totaling \$448,886 from the sales of 43,073 shares of Solazyme, Inc., which settled on January 2 and January 6, 2014, and 2,075 shares of Champions Oncology, Inc., which settled on January 3, 2014.

Funds Held in Escrow from Sale of Investment. At December 31, 2014, there were funds held in escrow fair valued at \$306,802 relating to the sale of Molecular Imprints, Inc., to Canon, Inc. At December 31, 2013, there were funds held in escrow fair valued at \$1,786,390 relating to the sale of Xradia, Inc., to Carl Zeiss AG. Funds held in escrow are valued using certain discounts applied to the amounts withheld. Funds held in escrow totaling \$1,235,312 and \$1,139,515 from the Xradia transaction were released in January and July of 2014, respectively. Funds held in escrow valued at \$306,802 from the Molecular Imprints transaction are expected to be released in April of 2016 and April of 2017, net of any settlement of any indemnity claims and expenses related to the transaction. If the funds held in escrow for this transaction are released in full, we would receive \$625,000 and realize a gain of \$318,198.

Prepaid Expenses. We include prepaid insurance premiums and deferred financing charges in "Prepaid expenses." Prepaid insurance premiums are recognized over the term of the insurance contract and are included in "Insurance expense" in the Consolidated Statements of Operations. Deferred financing charges consist of fees and expenses paid in connection with the closing of loan facilities and are capitalized at the time of payment. Deferred financing charges are amortized over the term of the loan facility discussed in "Note 4. Debt." Amortization of the financing charges is included in "Interest and other debt expense" in the Consolidated Statements of Operations.

Property and Equipment. Property and equipment are included in "Other assets" and are carried at \$219,729 and \$246,138 at December 31, 2014, and December 31, 2013, respectively, representing cost, less accumulated depreciation of \$399,373 and \$375,600, respectively. Depreciation is provided using the straight-line method over the estimated useful lives of the property and equipment. We estimate the useful lives to be five to ten years for furniture and fixtures, three years for computer equipment, and the lesser of ten years or the remaining life of the lease for leasehold improvements. All of our fixed assets are pledged as collateral under the Company's four-year \$20,000,000 Multi-Draw Term Loan Facility Credit Agreement, by and among the Company, as borrower, Orix Corporate Capital, Inc., as administrative agent and lender and the other lenders party thereto from time to time (the "Loan Facility").

Post Retirement Plan Liabilities. The Company provides a Retiree Medical Benefit Plan for employees who meet certain eligibility requirements. Until it was terminated on May 5, 2011, the Company also provided an Executive Mandatory Retirement Benefit Plan for certain individuals employed by us in a bona fide executive or high policy-making position. The net periodic postretirement benefit cost for the year includes service cost for the year and interest on the accumulated postretirement benefit obligation. Unrecognized actuarial gains and losses are recognized as net periodic benefit cost pursuant to the Company's historical accounting policy. The impact of plan amendments is amortized over the employee's average service period as a reduction of net periodic benefit cost. Unamortized plan amendments are included in "Accumulated other comprehensive income" in the Consolidated Statements of Assets and Liabilities.



Interest Income Recognition. Interest income, including amortization of premium and accretion of discount, is recorded on an accrual basis. When accrued interest is determined not to be recoverable, the Company ceases accruing interest and writes off any previously accrued interest. Securities are deemed to be non-income producing if, on their last interest or dividend date, no cash was paid or no cash or in-kind dividends were declared. These write-offs are reversed through interest income. During the years ended December 31, 2014, December 31, 2013, and December 31, 2012, the Company earned \$260,392, \$323,121 and \$322,561, respectively, in interest on U.S. government securities, senior secured debt, participation agreements, subordinated secured debt, non-convertible promissory notes and interest-bearing accounts. During the years ended December 31, 2014, December 31, 2013, and December 31, 2012, the Company recorded, on a net basis, \$170,741, \$67,781 and \$235,806, respectively, of bridge note interest. The total for the years ended December 31, 2014, December 31, 2013, and December 31, 2012, included a partial write-off of previously accrued bridge note interest of \$77,268, \$218,213 and \$0, respectively. During the years ended December 31, 2014, December 31, 2013, and December 31, 2012, the Company earned \$0, \$80,000 and \$107,586, respectively, on rental income from the sublet of our office space at 420 Florence Street, Palo Alto, CA.

Yield-Enhancing Fees on Debt Securities. Yield-enhancing fees received in connection with our venture debt investments are deferred. The unearned fee income is accreted into income based on the effective interest method over the life of the investment. Total yield-enhancing fees accreted into investment income were \$52,610, \$46,243 and \$56,274 for the years ended December 31, 2014, December 31, 2013, and December 31, 2012, respectively.

Rental Income From Sublease. During the years ended December 31, 2013, and 2012, the Company earned \$80,000 and \$107,586, respectively, in rental income from the sublet of our office space at 420 Florence Street, Palo Alto, CA. This lease expired in August 2013, and, accordingly, we had no rental income from the sublease in 2014.

Fees for Providing Managerial Assistance to Portfolio Companies. During 2014, the Company earned income of \$86,667 from a consulting agreement whereby one of its employees provided managerial assistance to one of its portfolio companies. There were no such agreements during 2013 or 2012.

Call Options. The Company writes covered call options on publicly traded securities with the intention of earning option premiums. Option premiums may increase the Company's realized gains and, therefore, may help increase distributable income, but may limit the realized gains on the security. When a company writes (sells) an option, an amount equal to the premium received by the Company is recorded in the Consolidated Statements of Assets and Liabilities as a liability. The amount of the liability is subsequently marked-to-market to reflect the current market value of the option written. When an option expires, the Company realizes a gain on the option to the extent of the premiums received. Premiums received from writing options that are exercised or closed are added to the proceeds or offset against the amount paid on the transaction to determine the realized gain or loss. At December 31, 2014, and December 31, 2013, the Company had 0 and 150,000 shares, respectively, of Solazyme, Inc., covered by call option contracts. In the event these contracts are exercised, the Company would be required to deliver those shares to the counterparty.



Stock-Based Compensation. The Company has a stock-based employee compensation plan. The Company accounts for the Amended and Restated Harris & Harris Group, Inc. 2012 Equity Incentive Plan (the "Stock Plan") by determining the fair value of all share-based payments to employees, including the fair value of grants of employee stock options and restricted stock awards, and records these amounts as an expense in the Consolidated Statements of Operations over the vesting period with a corresponding increase to our additional paid-in capital. At December 31, 2014, and December 31, 2013, the increase to our operating expenses was offset by the increase to our additional paid-in capital, resulting in no net impact to our net asset value. Additionally, the Company does not record the potential tax benefits associated with the expensing of stock options or restricted stock because the Company currently intends to qualify as a regulated investment company ("RIC") under Subchapter M of the Code, and the deduction attributable to such expensing, therefore, is unlikely to provide any additional tax savings. The amount of non-cash, stock-based compensation expense recognized in the Consolidated Statements of Operations is based on the fair value of the awards the Company expects to vest, recognized over the vesting period on a straight-line basis for each award, and adjusted for actual awards vested and pre-vesting forfeitures. The forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if the actual forfeiture rate differs from the estimated rate and is accounted for in the current period and prospectively. See "Note 7. Stock-Based Compensation" for further discussion.

Rent expense. Our lease at 1450 Broadway, New York, New York, commenced on January 21, 2010. The lease expires on December 31, 2019. The base rent is \$36 per square foot with a 2.5 percent increase per year over the 10 years of the lease, subject to a full abatement of rent for four months and a rent credit for six months throughout the lease term. Certain leasehold improvements were also paid for on our behalf by the landlord, the cost of which is accounted for as property and equipment and "Deferred rent" in the accompanying Consolidated Statements of Assets and Liabilities. These leasehold improvements are depreciated over the lease term. We also currently lease office space in California and leased office space in North Carolina until December 31, 2014. We apply these rent abatements, credits, escalations and landlord payments on a straight-line basis in the determination of rent expense over the lease term.

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

Income Taxes. As we intend to qualify as a RIC under Subchapter M of the Code, the Company does not accrue for income taxes. The Company has capital loss carryforwards that can be used to offset net realized capital gains. The Company recognizes interest and penalties in income tax expense. We pay federal, state and local income taxes on behalf of our wholly owned subsidiary, Ventures, which is a C corporation. See "Note 10. Income Taxes" for further discussion.

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. The Company does not isolate the portion of the results of operations that arises from changes in foreign currency rates on investments held on its Consolidated Statements of Operations.

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

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

Recent Accounting Pronouncements. In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," which is the new comprehensive revenue recognition standard that will supersede all existing revenue recognition guidance under GAAP. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to a customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This ASU is effective for annual and interim periods beginning on or after December 15, 2016, and early adoption is not permitted. Entities will have the option of using either a full retrospective approach or a modified approach to adopt the guidance in the ASU. The Company is currently evaluating the impact of adopting this standard.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could be Achieved after the Requisite Service Period." This ASU provides more explicit guidance for treating share-based payment awards that require a specific performance target that affects vesting and that could be achieved after the requisite service period as a performance condition. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2015. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, "Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern." This ASU requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity's ability to continue as a going concern. The new guidance applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company does not expect that the adoption of this standard will have a material impact on its consolidated financial statements.



In August 2014, the FASB issued an accounting standards update to require evaluation of whether there are conditions and events that raise substantial doubt about an entity's ability to continue as a going concern within one year after its financial statements are issued (or available to be issued when applicable) and, if so, disclosure of that fact. The standard requires the Company to make this evaluation for both annual and interim reporting periods, if applicable, and disclose whether its plans to alleviate that doubt. The standard is effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. The Company does not expect this accounting standards update to have an impact on its consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, *Amendments to the Consolidation Analysis (Topic 810)*. The update primarily amends the criteria used to evaluate whether certain variable interest entities should be consolidated. The update also modifies the criteria used to determine whether partnerships and similar entities are variable interest entities. The update is effective for interim and annual periods beginning after December 15, 2016, with early adoption permitted, including in the interim periods. The Company is currently evaluating the impact of this update on its financial statements.

### **NOTE 3. BUSINESS RISKS AND UNCERTAINTIES**

We invest primarily in privately held companies, the securities of which are inherently illiquid. We also have investments in small publicly traded companies. Although these companies are publicly traded, their stock may not trade at high volumes and prices can be volatile, which may restrict our ability to sell our positions. We may also be subject to restrictions on transfer and/or other lock-up provisions after these companies initially go public. These privately held and publicly traded businesses tend to not have attained profitability, and many of these businesses also lack management depth and have limited or no history of operations. Because of the speculative nature of our investments and the lack of a liquid market for and restrictions on transfers of privately held investments, there is greater risk of loss relative to traditional marketable investment securities.

We do not choose investments based on a strategy of diversification. We also do not rebalance the portfolio should one of our portfolio companies increase in value substantially relative to the rest of the portfolio. Therefore, the value of our portfolio may be more vulnerable to microeconomic events affecting a single sector, industry or portfolio company and to general macroeconomic events that may be unrelated to our portfolio companies. These factors may subject the value of our portfolio to greater volatility than a company that follows a diversification strategy. As of December 31, 2014, and December 31, 2013, our largest 10 investments by value accounted for approximately 82 percent and 75 percent, respectively, of the value of our equity-focused venture capital portfolio. Our largest three investments, by value, Adesto Technologies Corporation, Metabolon, Inc., and Enumeral Biomedical Holdings, Inc., accounted for approximately 17 percent, 12 percent and 10 percent, respectively, of our equity-focused venture capital portfolio at December 31, 2014. Adesto Technologies and Metabolon are privately held portfolio companies. Enumeral Biomedical is a publicly traded portfolio company. Our largest three investments, by value, Adesto Technologies Corporation, Metabolon, Inc., and Molecular Imprints, Inc., accounted for approximately 17 percent, 12 percent and 9 percent, respectively, of our equity-focused venture capital portfolio at December 31, 2013.





Approximately 98 percent of the portion of our equity-focused venture capital portfolio that was fair valued was comprised of securities of 26 privately held companies, the warrants of publicly traded Champions Oncology, Inc., and securities of Enumeral Biomedical Holdings, Inc. Because there is typically no public or readily ascertainable market for our interests in the small privately held companies in which we invest, the valuation of the securities in that portion of our portfolio is determined in good faith by our Valuation Committee, which is comprised of all of the independent members of our Board of Directors. The values are determined in accordance with our Valuation Procedures and are subject to significant estimates and judgments. The fair value of the securities in our portfolio may differ significantly from the values that would be placed on these securities if a ready market for the securities existed. Any changes in valuation are recorded in our Consolidated Statements of Operations as "Net decrease (increase) in unrealized depreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be significant.

#### **NOTE 4. DEBT**

On September 30, 2013, the Company terminated the \$10,000,000 Revolving Loan Agreement by and between the Company and TD Bank, N.A., dated February 24, 2011. At the date of termination, there was no principal outstanding under this credit facility, and no termination fees were incurred in connection with ending this credit facility.

On September 30, 2013, the Company entered into the Loan Facility, which may be used to fund investments in portfolio companies. The Loan Facility replaced the Company's prior credit facility with TD Bank, NA. The Loan Facility, among other things, matures on September 30, 2017, and bears interest at 10 percent per annum in cash. The Company has the option to have interest accrue at a rate of 13.5 percent per annum if the Company decides not to pay interest in cash monthly. The Company currently plans to pay interest in cash if and when any borrowings are outstanding. The Loan Facility also requires payment of a draw fee on each borrowing equal to 1.0 percent of such borrowing and an unused commitment fee of 1.0 percent per annum. Fee payments under the Loan Facility are made quarterly in arrears. The Company may prepay the loans or reduce the aggregate commitments under the Loan Facility at any time prior to the maturity date, as long as certain conditions are met, including payment of required prepayment or termination fees. The Loan Facility is secured by all of the assets of the Company and its wholly owned subsidiaries, subject to certain customary exclusions. The Loan Facility contains certain affirmative and negative covenants, including without limitation: (a) maintenance of certain minimum liquidity requirements; (b) maintenance of an eligible asset leverage ratio of not less than 4.0:1.0; (c) limitations on liens; (d) limitations on the incurrence of additional indebtedness; and (e) limitations on structural changes, mergers and disposition of assets (other than in the normal course of our business activities).

At December 31, 2014, and December 31, 2013, the Company had no outstanding debt. The weighted average annual interest rate for the year ended December 31, 2014, and December 31, 2013, was zero percent, exclusive of amortization of closing fees and other expenses. The weighted average debt outstanding for the year ended December 31, 2014, and December 31, 2013, was \$0. The remaining capacity under the Loan Facility was \$20,000,000 at December 31, 2014, and December 31, 2013. Unamortized fees and expenses of \$480,921 and \$655,801 related to establishing the Loan Facility are included as "Prepaid expenses" in the Consolidated Statements of Assets and Liabilities as of December 31, 2014, and December 31, 2013, respectively. These amounts are amortized over the term of the Loan Facility, and \$174,880 and \$44,199 was amortized in 2014 and 2013, respectively. The Company paid \$202,778 and \$62,486 in non-utilization fees during 2014 and 2013, respectively. At December 31, 2014, the Company was in compliance with all covenants required by the Loan Facility.

#### **NOTE 5. FAIR VALUE OF INVESTMENTS**

At December 31, 2014, our financial assets were categorized as follows in the fair value hierarchy:

Description	Fair Value Measurement at Reporting Date Using:			
	December 31, 2014	Unadjusted Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Privately Held Portfolio Companies:</b>				
Preferred Stock	\$ 70,969,603	\$ 0	\$ 0	\$ 70,969,603
Bridge Notes	2,163,916	0	0	2,163,916
Warrants	2,026,864	0	0	2,026,864
Rights to Milestone Payments	3,193,865	0	0	3,193,865
Common Stock	535,280	0	0	535,280
Senior Secured Debt	1,203,299	0	0	1,203,299
Subordinated Secured Debt	979,450	0	0	979,450
Options	50,690			50,690
<b>Publicly Traded Portfolio Companies:</b>				
Common Stock	\$ 8,641,873	\$ 1,390,695	\$ 0	\$ 7,251,178
<b>Total Investments:</b>	<b>\$ 89,764,840</b>	<b>\$ 1,390,695</b>	<b>\$ 0</b>	<b>\$ 88,374,145</b>
<b>Funds Held in Escrow From Sales of Investments:</b>	<b>\$ 306,802</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 306,802</b>
<b>Total Financial Assets:</b>	<b>\$ 90,071,642</b>	<b>\$ 1,390,695</b>	<b>\$ 0</b>	<b>\$ 88,680,947</b>



*Significant Unobservable Inputs*

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

	<b>Fair Value at December 31, 2014</b>	<b>Valuation Technique(s)</b>	<b>Unobservable Input</b>	<b>Range (Weighted Average<sup>(a)</sup>)</b>
Preferred Stock	\$33,860,023	Hybrid Approach	Private Offering Price Volatility Time to Exit Discount for Lack of Marketability	\$0.71 - 2.90 (\$1.66) 46.6% - 58.8% (49.4%) 0.33 - 2 Years (1.12) 0% - 16% (7%)
Preferred Stock	22,174,585	Income Approach	Private Offering Price Non-Performance Risk Volatility Time to Exit	\$0 - \$5.97 (\$2.60) 0% - 50% (1.2%) 51.4% - 94.4% (62%) 2 - 4.5 Years (2.8)
Preferred Stock	14,934,995	Market Approach	Private Offering Price Non-Performance Risk Volatility Revenue Multiples Time to Exit Discount for Lack of Marketability	\$0 - \$1.75 (\$1.03) 0% (0%) 33.90% - 64.2% (47%) 2.2 - 4.6 (3.5) 2 - 4.5 Years (2.2) 0% - 21% (10%)
Bridge Notes	834,673	Hybrid Approach	Private Offering Price Non-Performance Risk Volatility Time to Exit	\$1.00 (\$1.00) 0% (0%) 58.8% (58.8%) 0.33 Years (0.33)
Bridge Notes	376,983	Income Approach	Private Offering Price Non-Performance Risk	\$1.00 (\$1.00) 0% (0%)
Bridge Notes	952,260	Market Approach	Private Offering Price Non-Performance Risk	\$1.00 (\$1.00) 0% (0%)
Common Stock	22,752	Hybrid Approach	Private Offering Price Non-Performance Risk Volatility Time to Exit	\$1.00 (\$1.00) 0% (0%) 58.8% (58.8%) 0.33 Years (0.33)

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

Common Stock	512,507	Income Approach	Private Offering Price	\$1.00 - \$3.71 (\$2.72)
			Non-Performance Risk	0% (0%)
			Volatility	52.7% - 94.4% (65%)
			Time to Exit	3 Years (3)
Common Stock	21	Market Approach	Private Offering Price	\$0.0001 - \$0.001 (\$0.0001)
			Non-Performance Risk	0% (0%)

147

	Fair Value at December 31, 2014	Valuation Technique(s)	Unobservable Input	Range (Weighted Average <sup>(a)</sup> )
Warrants	2,026,864	Income Approach	Private Offering Price	\$0.30 - 2.66 (\$1.46)
			Volatility	33.9% - 107% (73.1%)
			Expected Term	0.23 - 9.10 Years (3.5)
Rights to Milestone Payments	3,193,865	Probability Weighted	Probability of Achieving Independent Milestones	0% - 80% (45%)
		Discounted Cash Flow	Probability of Achieving Dependent Milestones	0% - 75% (24%)
Subordinated Secured Debt	979,450	Income Approach	Effective Yield	17.8% (17.8%)
Senior Secured Debt	1,203,299	Income Approach	Effective Yield	0 - 15.8% (5.0%)
Funds Held in Escrow From Sales of Investments	306,802	Market Approach	Escrow Discounts	50% (50%)
Options	50,690	Income Approach	Stock Price	\$1.05 (\$1.05)
			Volatility	88.9% (88.9%)
			Expected Term	9.6 Years (9.6)
OTC Traded			Volatility of Public Comparables	0% - 88.9% (68.7%)
			Discount for Lack of Marketability	0% - 16.4% (12.7%)
Common Stock	7,251,178	Market Approach	Escrow Discounts	0% - 50% (0.4%)
Total	\$ 88,680,947			

(a)

Weighted average based on fair value at December 31, 2014.

Valuation Methodologies and Inputs for Level 3 Assets

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

148



*Preferred Stock, Bridge Notes and Common Stock*

Preferred stock, bridge notes and common stock are valued by either a market, income or hybrid approach using internal models with inputs, most of which are not market observable. Common inputs for valuing Level 3 preferred stock, bridge note and private common stock investments include prices from recently executed private transactions in a company's securities or unconditional firm offers, revenue multiples of comparable publicly traded companies, merger and acquisition ("M&A") transactions consummated by comparable companies, discounts for lack of marketability, rights and preferences of the class of securities we own as compared with other classes of securities the portfolio company has issued, particularly related to potential liquidity scenarios of an initial public offering ("IPO") or an acquisition transaction, estimated time to exit, volatilities of comparable publicly traded companies and management's best estimate of risk attributable to non-performance risk. Certain securities are valued using the present value of future cash flows. We define non-performance risk as the risk that the price per share (or implied valuation of a portfolio company) or the effective yield of a debt security of a portfolio company, as applicable, does not appropriately represent the risk that a portfolio company with negative cash flow will be: (a) unable to raise capital, will need to be shut down and will not return our invested capital; or (b) able to raise capital, but at a valuation significantly lower than the implied post-money valuation of the last round of financing. We assess non-performance risk for each private portfolio company quarterly. Our assessment of non-performance risk typically includes an evaluation of the financial condition and operating results of the company, the company's progress towards milestones, and the long-term potential of the business and technology of the company and how this potential may or may not affect the value of the shares owned by us. An increase to the non-performance risk or a decrease in the private offering price of a future round of financing from that of the most recent round would result in a lower fair value measurement and/or a change in the distribution of value among the classes of securities we own. An increase in the volatility assumption generally increases the enterprise value calculated in an option pricing model. An increase in the time to exit assumption also generally increases the enterprise value calculated in an option pricing model. Variations in the expected time to exit or expected volatility assumptions have a significant impact on fair value.

Option pricing models place a high weighting on liquidation preferences, which means that small differences in how the preferences are structured can have a material effect on the fair value of our securities at the time of valuation and also on future valuations should additional rounds of financing occur with senior preferences. As such, valuations calculated by option pricing models may not increase if 1) rounds of financing occur at higher prices per share, 2) liquidation preferences include multiples on investment, 3) the amount of invested capital is small and/or 4) liquidation preferences are senior to prior rounds of financing.

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



### ***Warrants***

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

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

### ***Rights to Milestone Payments***

Rights to milestone payments are valued using a probability-weighted discounted cash flow model. As part of Amgen Inc.'s acquisition of our former portfolio company, BioVex Group, Inc., we are entitled to potential future milestone payments based upon the achievement of certain regulatory and sales milestones. We are also entitled to future milestone payments from Laird Technologies Inc.'s acquisition of our former portfolio company, Nextreme Thermal Solutions, Inc., and from Canon, Inc.'s acquisition of Molecular Imprints, Inc. We assign probabilities to the achievements of the various milestones. Milestones identified as independent milestones can be achieved irrespective of the achievement of other contractual milestones. Dependent milestones are those that can only be achieved after another, or series of other, milestones are achieved. The interest rates used in these models are observable inputs from sources such as the published interest rates for corporate bonds of the acquiring or comparable companies.

### ***Participation Agreements and Senior Secured Debt***

We invest in venture debt investments through senior secured debt. We value these securities using an income approach. The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Common inputs for valuing Level 3 debt investments include: the effective yield of the debt investment or, in the case where we have received warrant coverage, the warrant-adjusted effective yield of the security, adjustments for changes in the yields of comparable publicly traded high-yield debt funds and risk-free interest rates and an assessment of non-performance risk. For venture debt investments, an increase in yields would result in a lower fair value measurement. Furthermore, yields would decrease, and value would

increase, if the company is exceeding targets and risk has been substantially reduced from the level of risk that existed at the time of investment. Yields would increase, and values would decrease, if the company is failing to meet its targets and risk has been increased from the level of risk that existed at the time of investment. Historically, we also invested in venture debt through participation agreements. As of December 31, 2014, the amounts held in participation agreements consist solely of warrants. These warrants are valued using the Black-Scholes-Merton pricing model as discussed in "Warrants."

The following chart shows the components of change in the financial assets categorized as Level 3 for the year ended December 31, 2014.

	Beginning Balance 1/1/2014	Total Realized (Losses) Gains Included in Changes in Net Assets	Transfers	Total Unrealized Appreciation (Depreciation) Included in Changes in Net Assets	Investments in Portfolio Companies, Interest on Bridge Notes, and Amortization of Loan Fees, Net	Disposals and Settlements	Ending Balance 12/31/2014	Amount Total (Depre Apprec for the Period Include Change Net Assets Attribu to the Change Unreal Gains Losses Relatin Assets Held a the Report Date
Preferred Stock	\$71,577,059	\$(7,472,760)	\$(371,644 ) <sup>1,2</sup>	\$5,555,721	\$8,191,037	\$(6,509,810 )	\$70,969,603	\$(6,28
Bridge Notes	6,044,114	(50,000 )	(4,968,041) <sup>1</sup>	(2,253,312)	3,434,976	(43,821 )	2,163,916	(2,30
Common Stock	108,668	0	1,130,362 <sup>1</sup>	(919,782 )	216,032	0	535,280	(919,7
Warrants	800,487	0	65,250 <sup>1</sup>	519,818	641,309	0	2,026,864	519,8
Rights to Milestone Payments	3,489,433	536,813	629,670	608,904	0	(2,070,955 )	3,193,865	608,9
Participation Agreements	777,195	84,371	0	(68,196 )	5,892	(799,262 )	0	0
Senior Secured Debt	1,511,828	0	0	17,364	(12,536 )	(313,357 )	1,203,299	17,36

Subordinated Secured Debt	0	0	0	197	979,253	0	979,450	197
Funds Held in Escrow From Sales of Investments	1,786,390	270,241	625,000 <sup>2</sup>	0	0	(2,374,829 )	306,802	0
Options	0	0	0	50,690	0	0	50,690	50,690
OTC Traded Common Stock	0	0	2,889,403 <sup>1</sup>	3,402,150	959,625	0	7,251,178	3,402,150
Total	\$86,095,174	\$(6,631,335)	\$0	\$6,913,554	\$14,415,588	\$(12,112,034)	\$88,680,947	\$(4,900,000)

<sup>1</sup>Transfers among asset classes are owing to conversions at financing events. These do not represent transfers in or out of Level 3.

<sup>2</sup> There was a \$625,000 transfer from "Preferred Stock" into "Funds Held in Escrow From Sales of Investments" owing to the sale of Molecular Imprints, Inc., to Canon, Inc.

There were no transfers out of Level 3 investments during the year ended December 31, 2014.

At December 31, 2013, our financial assets were categorized as follows in the fair value hierarchy:

Description	Fair Value Measurement at Reporting Date Using:			
	December 31, 2013	Unadjusted Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government Securities:	\$18,999,810	\$ 18,999,810	\$ 0	\$ 0
Privately Held Portfolio Companies:				
Preferred Stock	\$71,577,059	\$ 0	\$ 0	\$ 71,577,059
Bridge Notes	6,044,114	0	0	6,044,114
Warrants	800,487	0	0	800,487
Rights to Milestone Payments	3,489,433	0	0	3,489,433
Common Stock	108,668	0	0	108,668
Senior Secured Debt	1,511,828	0	0	1,511,828
Participation Agreement	777,195	0	0	777,195
Non-Convertible Promissory Note	4,043,381	0	4,043,381	0
Publicly Traded Portfolio Companies:				
Common Stock	\$5,547,294	\$ 5,547,294	\$ 0	\$ 0
Total Investments:	\$112,899,269	\$ 24,547,104	\$ 4,043,381	\$ 84,308,784
Funds Held in Escrow From Sales of Investments:	\$1,786,390	\$ 0	\$ 0	\$ 1,786,390
Total Financial Assets:	\$114,685,659	\$ 24,547,104	\$ 4,043,381	\$ 86,095,174
Liabilities:				
Written Call Options	\$103,500	\$ 103,500	\$ 0	\$ 0
Total Liabilities:	\$103,500	\$ 103,500	\$ 0	\$ 0

#### *Significant Unobservable Inputs*

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





	Fair Value at December 31, 2013	Valuation Techniques(s)	Unobservable Input	Range (Weighted Average <sup>(a)</sup> )
Preferred Stock	\$ 1,419,855	Hybrid Approach	Private Offering Price	\$1.38 (\$1.38)
			Probability of Exit Outcomes	25% - 75% (b)
	4,235,562	Income Approach	Probability of Achieving Milestones	26% - 80% (b)
			Non-Performance Risk	0% - 100% (0%)
Bridge Notes	2,679,932	Hybrid Approach	Probability of Exit Outcomes	0% - 100% (b)
			Probability of Achieving Milestones	0% - 100% (b)
	333,845	Income Approach	Private Offering Price	\$0.10 - \$3.91 (\$1.30)
			Market Approach	0% - 97% (5%)
3,030,337	Market Approach	Revenue Multiples	1.15 - 7.27 (1.06)	
		Illiquidity Discounts	20% - 30% (2.5%)	
Common Stock	108,668	Market Approach	Probability of Exit Outcomes	0% - 100% (b)
			Private Offering Price	\$1.00 (\$1.00)
Warrants	800,487	Black-Sholes-Merton Model	Non-Performance Risk	0% (0%)
			Stock Price	\$0.06 - \$2.76 (\$1.36)
			Volatility	22.6% - 107% (105%)
Rights to Milestone Payments	3,489,433	Probability Weighted Discounted Cash Flow	Expected Term	0.50 - 9.20 Years (3.3)
			Probability of Achieving Independent Milestones	0% - 80% (b)
Participation Agreements <sup>(c)</sup>	777,195	Income Approach	Probability of Achieving Dependent Milestones	0% - 30% (b)
			Warrant Adjusted Effective Yield	21.5% (21.5%)
			Effective Yield	21.5% (21.5%)
			Non-Performance Risk	0% (0%)
			Participation Payment Risk	0% (0%)
			Stock Price	\$0.09 - \$0.50 (\$0.34)
1,511,828	Income Approach	Volatility	107% (107%)	
		Expected Term	3.72 - 8.25 Years (5.59)	
			Effective Yield	15.8% - 22.7% (19.6%)
			Non-Performance Risk	0% (0%)

Senior Secured  
Debt

Funds Held in  
Escrow From  
Sales

of Investments	1,786,390	Escrow Discounts	50% (50%)
----------------	-----------	------------------	-----------

Total	\$ 86,095,174
-------	---------------

(a) Weighted average based on fair value at December 31, 2013.

(b) Weighted average has not been disclosed owing to the wide range of possible values.

(c) In connection with our investments in participation agreements in GEO Semiconductor, Inc., and OHSO Clean, Inc., we received warrants to purchase stock. See "Warrants" for a discussion of the valuation methodology used.

The following chart shows the components of change in the financial assets categorized as Level 3 for the year ended December 31, 2013.

	<b>Beginning Balance 1/1/2013</b>	<b>Total Realized Gains (Losses) Included in Changes in Net Assets</b>	Transfers	<b>Total Unrealized (Depreciation) Appreciation Included in Changes in Net Assets</b>	<b>Investments in Portfolio Companies, Interest on Bridge Notes, and Amortization of Loan Fees, Net</b>	Disposals	<b>Ending Balance 12/31/2013</b>
Preferred Stock	\$78,615,582	\$10,006,915	\$1,817,476 <sup>1</sup>	\$(17,635,033)	\$12,779,034	\$(14,006,915)	\$71,577,059
Bridge Notes	4,152,634	0	(1,822,831) <sup>1</sup>	(1,078,514 )	4,792,825	0	6,044,114
Common Stock	108,667	(4,384,762 )	0	4,384,762	1	0	108,668
Warrants	586,320	0	5,355 <sup>1</sup>	188,412	20,400	0	800,487
Rights to Milestone Payments	3,400,734	0	0	88,699	0	0	3,489,433
Participation Agreements	1,138,148	90,255	0	(22,807 )	5,966	(434,367 )	777,195
Subordinated Secured Debt	120,410	15,058	0	(10,836 )	368	(125,000 )	0
Senior Secured Debt	1,075,870	0	0	397,325	339,907	(301,274 )	1,511,828
Non-Convertible Promissory Note	3,033,338	0	(3,033,338)	0	0	0	0
	1,348,227	0	(1,547,827)	0	199,600	0	0

Publicly Traded  
Common Stock

## Funds Held in Escrow

From Sales of Investments	1,052,345	766,448	0	0	1,168,671	(1,201,074 )	1,786,390
------------------------------	-----------	---------	---	---	-----------	--------------	-----------

Total	\$94,632,275	\$6,493,914	\$(4,581,165)	\$(13,687,992)	\$19,306,772	\$(16,068,630)	\$86,095,174
-------	--------------	-------------	---------------	----------------	--------------	----------------	--------------

<sup>1</sup>Transfers among asset classes are owing to conversions at financing events. These do not represent transfers in or out of Level 3.

We elected to use the beginning of period values to recognize transfers in and out of Level 2 and Level 3 investments. For the year ended December 31, 2013, there were transfers out of Level 3 totaling \$4,581,165. Our shares of Champions Oncology, Inc., transferred from a Level 3 investment to a Level 1 investment owing to the market for the shares becoming active with increased and sustained trading volume and the lapse of restrictions on 626,523 shares that were previously restricted. Our non-convertible promissory note in Molecular Imprints, Inc., transferred from a Level 3 investment to a Level 2 investment owing to an acquisition offer.

**NOTE 6. DERIVATIVES**

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

Transactions in written call options during the year ended December 31, 2014, were as follows:

	Number of Contracts	Premium
Call options outstanding at December 31, 2013	1,500	\$ 112,382
Call options written	1,500	342,735
Call options expired	(1,500 )	(342,735)
Call options called in assignment transactions	0	0
Call options terminated in closing transactions	(1,500 )	(112,382)
Call options outstanding at December 31, 2014	0	\$0

At December 31, 2014, and December 31, 2013, we had rights to milestone payments from Amgen, Inc.'s acquisition of our former portfolio company, BioVex Group, Inc. These milestone payments were fair valued at \$2,564,917 and \$3,489,433, respectively, and are contingent upon certain milestones being achieved in the future. At December 31, 2014, and December 31, 2013, we had rights to milestone payments from Laird Technologies, Inc.'s acquisition of our former portfolio company, Nextreme Thermal Solutions, Inc. These milestone payments were fair valued at \$0 as of December 31, 2014, and December 31, 2013. At December 31, 2014, we had rights to milestone payments from Canon, Inc.'s acquisition of our former portfolio company, Molecular Imprints, Inc. These milestone payments were fair valued at \$628,948 as of December 31, 2014.

The following tables present the value of derivatives held at December 31, 2014, and the effect of derivatives held during the year ended December 31, 2014, along with the respective location in the financial statements.

**Statements of Assets and Liabilities:**

Derivatives	Assets		Liabilities	
	Location	Fair Value	Location	Fair Value
Equity Contracts	—	—	Written call options payable	\$ 0
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Investments	\$2,564,917	—	—
Laird Technologies, Inc. Rights to Milestone Payments from Acquisition of Nextreme Thermal Solutions, Inc.	Investments	\$0	—	—
Canon, Inc. Rights to Milestone Payments from Acquisition of Molecular Imprints, Inc.	Investments	\$628,948	—	—

**Statements of Operations:**

Derivatives	Location	Realized Gain/(Loss)	Change in unrealized (Depreciation)/Appreciation
Equity Contracts	Net Realized and Unrealized (Loss) Gain	\$ 232,079	\$ (8,882 )
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Net Realized and Unrealized (Loss) Gain	\$ 536,813	\$ 609,626
Laird Technologies, Inc. Rights to Milestone Payments from Acquisition of Nextreme Thermal Solutions, Inc.	Net Realized and Unrealized (Loss) Gain	\$ 0	\$ 0
Canon, Inc. Rights to Milestone Payments from Acquisition of Molecular Imprints, Inc.	Net Realized and Unrealized (Loss) Gain	\$ 0	\$ (722 )

Transactions in written call options during the year ended December 31, 2013, were as follows:

	Number of Contracts	Premium
Call options outstanding at December 31, 2012	2,000	\$50,000
Call options written	18,321	1,092,989
Call options expired	(2,065 )	(96,565 )
Call options called in assignment transactions	(9,356 )	(638,434 )
Call options terminated in closing transactions	(7,400 )	(295,608 )
Call options outstanding at December 31, 2013	1,500	\$112,382

We have also purchased put options as a method of limiting the downside risk that the price per share of this company may decrease substantially from current levels. A put option gives its holder the right to sell a specified number of shares of a specific security at a specific price (known as the exercise strike price) by a certain date.

The following tables present the value of derivatives held at December 31, 2013, and the effect of derivatives held during the year ended December 31, 2013, along with the respective location in the financial statements.

Derivatives	Assets		Liabilities	
	Location	Fair Value	Location	Fair Value
Equity Contracts			Written call options payable	\$ 103,500
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Investments	\$3,489,433	—	—
Laird Technologies, Inc. Rights to Milestone Payments from Acquisition of Nextreme Thermal Solutions, Inc.	Investments	\$0	—	—

**Statement of Operations**

Derivatives	Location	Realized (Loss)/Gain	Change in unrealized Appreciation/ (Depreciation)
Equity Contracts	Net Realized and Unrealized (Loss) Gain	\$ (72,491 )	\$ 1,382
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Net Realized and Unrealized (Loss) Gain	\$ 0	\$ 88,699
Laird Technologies, Inc. Rights to Milestone Payments from Acquisition of Nextreme Thermal Solutions, Inc.	Net Realized and Unrealized (Loss) Gain	\$ 0	\$ 0

**NOTE 7. STOCK-BASED COMPENSATION**



The Company maintains the Stock Plan, which provides for the grant of equity-based awards of stock options to our officers and employees and restricted stock to our officers, employees and non-employee directors subject to compliance with the 1940 Act and an exemptive order granted on April 3, 2012, by the SEC permitting us to award shares of restricted stock (the "Exemptive Order").

Under the Stock Plan, a maximum of 20 percent (6,200,120 shares) of our total shares of common stock issued and outstanding as of the 2012 Annual Meeting date, calculated on a fully diluted basis (31,000,601 shares), were available for awards under the Stock Plan. Under the Stock Plan, no more than 50 percent of the shares of stock reserved for the grant of the awards under the Stock Plan (up to an aggregate of 3,100,060 shares) 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. 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. Although the Stock Plan permits us to continue to grant stock options, our Board of Directors currently plans to discontinue further grants of stock options. As of December 31, 2014, 1,165,495 shares of restricted stock, or 3.8 percent, of the 31,000,601 total shares outstanding as of the effective date of the Stock Plan were outstanding. As of December 31, 2014, 1,423,912 options, or 4.6 percent, of the 31,000,601 total shares outstanding as of the effective date of the Stock Plan were outstanding, of which 1,128,261, or 79.2 percent, of all options outstanding were held in the estate of Charles E. Harris.

The Stock Plan will expire on June 7, 2022. 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.

#### *Stock Option Awards*

During the years ended December 31, 2014, 2013 and 2012, the Compensation Committee of the Board of Directors of the Company did not grant any stock options. On May 11, 2012, certain executive officers voluntarily cancelled 1,963,745 outstanding stock options for no consideration. Upon cancellation, we recognized \$1,365,242 in compensation expense related to these previously granted options. The Compensation Committee currently does not plan to grant new stock options to employees.

For the years ended December 31, 2014, December 31, 2013, and December 31, 2012, the Company recognized \$92,758, \$215,394, and \$1,973,569, respectively, of compensation expense in the Consolidated Statements of Operations related to stock options. The amount for the year ended December 31, 2012, includes \$1,365,242 related to the voluntary cancellation of stock options. As of December 31, 2014, there was no unrecognized compensation cost related to unvested stock options awards. As of December 31, 2013, and December 31, 2012, there was approximately \$92,756 and \$224,182, respectively, of unrecognized compensation cost related to unvested stock option awards.

No options were exercised during the years ended December 31, 2014, December 31, 2013, and December 31, 2012. Upon exercise, shares would be issued from our previously authorized but unissued shares.

A summary of the changes in outstanding stock options for the year ended December 31, 2014, is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Options Outstanding at January 1, 2014	1,425,372	\$ 9.77	\$ 6.27	2.68	\$ 0
Granted	0	0	0	0	
Exercised	0	0	0	0	
Forfeited or Expired	(1,460 )	4.49	2.11	0	
Options Outstanding and Exercisable at December 31, 2014	1,423,912	\$ 9.77	\$ 6.28	1.68	\$ 0

The aggregate intrinsic value in the table above with respect to outstanding options is calculated as the difference between the Company's closing stock price of \$2.95 on December 31, 2014, and the exercise price, multiplied by the number of in-the-money options. This amount represents the total pre-tax intrinsic value that would have been received by the option holders had all option holders exercised their awards on December 31, 2014.

The grant date fair value of options vested during the year ended December 31, 2014, was \$189,743. The grant date fair value of options vested during the year ended December 31, 2013, was \$202,269. The grant date fair value of options vested during the year ended December 31, 2012, was \$580,542, which included options vested for certain executive officers prior to the voluntary cancellation of 1,963,745 outstanding stock options on May 11, 2012.

At December 31, 2014, there were no unvested options. At December 31, 2013, there were 25,445 unvested options with a weighted average grant date fair value of \$7.46. At December 31, 2012, there were 56,505 unvested options with a weighted average grant date fair value of \$6.94.

During the year ended December 31, 2014, a total of 25,445 options vested having a weighted average grant date fair value of \$7.46. During the year ended December 31, 2013, a total of 31,060 options vested having a weighted average grant date fair value of \$6.51. During the year ended December 31, 2012, a total of 162,972 options vested having a weighted average grant date fair value of \$3.56.



*Restricted Stock*

On June 11, 2012, the Compensation Committee granted the employees a total of 1,780,000 shares of restricted stock. A total of 1,068,000 awards (60 percent) vest when the volume-weighted stock price is at or above pre-determined stock price targets over a 30-day period. These pre-determined stock price targets range from \$5.00 per share to \$9.00 per share. The remaining 712,000 of these shares (40 percent) have vesting dates ranging from December 31, 2012, through June 30, 2017, based on the employee's continued service to the Company. After this initial employee grant, the Compensation Committee does not plan to grant additional restricted stock to existing employees until at least June 11, 2015. On March 6, 2014, the Compensation Committee granted 26,360 shares of restricted stock to a new employee under service terms and volume weighted market price conditions matching those of the June 11, 2012, employee grant. Pursuant to the Exemptive Order, non-employee directors receive up to 2,000 shares of restricted stock annually, which vest pro rata over a three-year period from the date of the grant. On June 7, 2012, the non-employee directors received a grant of 14,000 shares of restricted stock. On May 2, 2013, an additional 12,000 shares of restricted stock were granted to the non-employee directors. On May 1, 2014, an additional 14,000 shares of restricted stock were granted to the non-employee directors.

The compensation expense for the service-based award is determined by the market price of our stock at the date of grant applied to the total number of shares we anticipate to fully vest. The market price for the March 6, 2014, employee service-based award was \$3.05. The market price for the May 1, 2014, grant to the non-employee directors was \$3.60.

The compensation expense for the market-based award is determined by the fair value of the award applied to the number of shares granted, net of estimated forfeitures. The fair value of the market-based award granted on March 6, 2014, was determined using a lattice model. The fair value of this award ranges from \$2.40 per share to \$2.64 per share and will be expensed over derived service periods ranging from approximately 44 to 86 months.

During 2014, a total of 255,379 shares of restricted stock were forfeited in connection with the voluntary termination of three of our employees and the resignation of one non-employee director. As a result, compensation cost of \$256,334 related to these awards was reversed, which reduced stock-based compensation cost for the period. For the year ended December 31, 2014, we recognized \$764,248 of compensation expense related to restricted stock awards. As of December 31, 2014, there was unrecognized compensation cost of \$1,859,672 related to restricted stock awards. This cost is expected to be recognized over a weighted average period of approximately 1.5 years.

Non-vested restricted stock awards as of December 31, 2014, and changes during the year ended December 31, 2014, were as follows:

	Shares	<b><u>Weighted-Average Grant Date Fair Value Per Share</u></b>
Outstanding at January 1, 2014	1,504,518	\$ 2.78
Granted	40,360	3.01
Vested based on service	(83,404 )	3.34
Shares withheld related to net share settlement of restricted stock	(40,600 )	3.37
Forfeited	(255,379 )	2.74
Outstanding at December 31, 2014	1,165,495	\$ 2.73

For the year ended December 31, 2013, we recognized \$1,034,362 of compensation expense related to restricted stock awards. As of December 31, 2013, there was unrecognized compensation cost of \$3,203,536 related to restricted stock awards.

Non-vested restricted stock awards as of December 31, 2013, and changes during the year ended December 31, 2013, were as follows:

	Shares	<b><u>Weighted-Average Grant Date Fair Value Per Share</u></b>
Outstanding at January 1, 2013	1,616,000	\$ 2.82
Granted	12,000	3.15
Vested based on service	(80,555 )	3.39
Shares withheld related to net share settlement of restricted stock	(40,927 )	3.38
Forfeited	(2,000 )	3.55
Outstanding at December 31, 2013	1,504,518	\$ 2.78

Under net settlement procedures currently applicable to our outstanding restricted stock awards for current employees, upon each settlement date, restricted stock awards are withheld to cover the required withholding tax, which is based on the value of the restricted stock award on the settlement date as determined by the closing price of our common stock on the vesting date. The remaining amounts are delivered to the recipient as shares of our common stock. During 2014, 124,004 restricted stock awards vested, of which 116,000 restricted stock awards were net settled by withholding 40,600 shares, which represented the employees' minimum statutory obligation for each such employee's applicable income and other employment taxes and remitted cash totaling of \$124,751 to the appropriate tax authorities.

During 2013, 121,482 restricted stock awards vested, of which 117,480 were net settled by withholding 40,927 shares, which represented the employees' minimum statutory obligation for each such employee's applicable income and other employment taxes and remitted cash totaling of \$123,182 to the appropriate tax authorities.

The amount remitted to the tax authorities for the employees' tax obligation was reflected as a financing activity within our Consolidated Statements of Cash Flows. The shares withheld by us as a result of the net settlement of restricted stock awards are not considered issued and outstanding, thereby reducing our shares outstanding used to calculate net asset value per share.

**NOTE 8. DISTRIBUTABLE EARNINGS**

As of December 31, 2014, December 31, 2013, and December 31, 2012, 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. These differences are immaterial.



The Company did not declare dividends for the years ended December 31, 2014, 2013 or 2012.

## **NOTE 9. EMPLOYEE BENEFITS**

### **401(k) Plan**

We adopted a 401(k) Plan covering substantially all of our employees. Matching contributions to the plan are at the discretion of the Compensation Committee. For the year ended December 31, 2014, the Compensation Committee approved a 100 percent match, which amounted to \$216,420. The 401(k) Company match for the years ended December 31, 2013, and December 31, 2012, was \$219,600 and \$208,383, respectively.

### **Medical Benefit Retirement Plan**

We administer a plan to provide medical and dental insurance for retirees and their spouses who, at the time of their retirement, have 10 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 (the "Medical Benefit Retirement Plan"). On March 7, 2013, the Board of Directors amended the Medical Benefit Retirement Plan. The amendment limits the medical benefit to \$10,000 per year for a period of ten years. The amendment does not affect benefits accrued by former employees or one current employee who is grandfathered under the former terms of the plan.

Our accumulated postretirement benefit obligation was re-measured as of the plan amendment date, which resulted in a \$1,101,338 decrease in our liability. A deferred gain of \$1,101,338 owing to this amendment was included in "Accumulated other comprehensive income" as of March 31, 2013. This amount is being amortized over a service period of 5.27 years. During the year ended December 31, 2014, a total of \$208,983 was amortized and included as a reduction of "Salaries, benefits and stock-based compensation" on our Consolidated Statements of Operations. During the year ended December 31, 2013, a total of \$174,152 was amortized and included as a reduction of "Salaries, benefits and stock-based compensation" on our Consolidated Statements of Operations. All of the amounts reported in the Consolidated Statements of Comprehensive Income (Loss) relate to the plan amendment.

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:



	2014	2013
Accumulated Postretirement Benefit Obligation at Beginning of Year	\$897,923	\$1,955,116
Service Cost	41,433	69,277
Interest Cost	42,075	43,033
Plan Amendment	0	(1,101,338)
Actuarial Loss (Gain)	84,245	(47,848 )
Benefits Paid	(22,946 )	(20,317 )
Accumulated Postretirement Benefit Obligation at End of Year	\$1,042,730	\$897,923

In accounting for the plan, the assumption made for the discount rate was 3.83 percent and 4.79 percent for the years ended December 31, 2014, and 2013, respectively. The assumed health care cost trend rates in 2014 were eight percent grading to five percent over six years for medical and five percent per year for dental. The assumed health care cost trend rates in 2013 were eight percent grading to five percent over six years for medical and five percent per year 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.

	1% Decrease in Rates	Assumed Rates	1% Increase in Rates
Aggregated Service and Interest Cost	\$ 76,464	\$83,508	\$ 91,794
Accumulated Postretirement Benefit Obligation	\$ 928,365	\$1,042,730	\$ 1,181,832

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 prior service cost and actuarial gains/losses 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, 2014, 2013, and 2012:

	2014	2013	2012
Service Cost	\$41,433	\$69,277	\$160,428
Interest Cost on Accumulated Postretirement Benefit Obligation	42,075	43,033	71,033
Amortization of Prior Service Cost	(208,983)	(174,152)	0

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

Amortization of Net (Gain)/Loss	11,833	10,496	514
Net Periodic Post Retirement Benefit Cost	\$(113,642)	\$(51,346 )	\$231,975

163

A total of \$208,983 in accumulated other comprehensive income is expected to be recognized as a component of net periodic post retirement benefit cost in 2015.

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

2015	\$ 19,601
2016	\$22,706
2017	\$25,798
2018	\$29,588
2019	\$32,276
2020 through 2024	\$254,321

For the year ended December 31, 2014, net unrecognized actuarial losses, which resulted primarily from the decrease in the discount rate, increased by \$72,412, which represents \$84,245 of actuarial losses arising during the year, offset by \$11,833 reclassification adjustment that increased the net periodic benefit cost for the year.

For the year ended December 31, 2013, net unrecognized actuarial gains, which resulted primarily from the increase in the discount rate, increased by \$58,344, which represents \$47,848 of actuarial gains arising during the year and a \$10,496 reclassification adjustment that increased the net periodic benefit cost for the year.

For the year ended December 31, 2012, net unrecognized actuarial losses, which resulted primarily from the decrease in the discount rate, increased by \$33,629, which represents \$34,143 of actuarial losses arising during the year offset by a \$514 reclassification adjustment that increased the net periodic benefit cost for the year.

**Executive Mandatory Retirement Benefit Plan**

On May 5, 2011, the Board of Directors of Harris & Harris Group, Inc., terminated the Amended and Restated Executive Mandatory Retirement Benefit Plan. The plan was adopted in 2003 in order to begin planning for eventual management succession for individuals who are employed by us in a bona fide executive or high policy-making position. The plan provided benefits required by age discrimination laws as a result of the Company's policy of mandatory retirement when such individuals attained the age of 65. Our former President accrued benefits under this plan prior to his retirement, and the termination of this plan has no impact on his accrued benefits. At December 31, 2014, and 2013, we had \$224,883 and \$222,337, respectively, accrued for benefits for this former employee under the plan, which is included in "Post retirement plan liabilities" on the Consolidated Statements of Assets and Liabilities.



**NOTE 10. INCOME TAXES**

We filed for the 1999 tax year to elect treatment as a RIC under Subchapter M of the Code and qualified for the same treatment for the years 2000 through 2013. However, there can be no assurance that we will qualify as a RIC for 2014 or subsequent years.

In the case of a RIC that furnishes capital to development corporations, there is an exception to the rule relating to the diversification of investments required to qualify for RIC treatment. This exception is available only to registered investment companies that the SEC determines to be principally engaged in the furnishing of capital to other corporations that are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available ("SEC Certification"). We have received SEC Certification since 1999, including for 2013, but it is possible that we may not receive SEC Certification in future years. We intend to apply for certification for 2014.

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.

For federal tax purposes, the Company's 2011 through 2014 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 2010 through 2014 tax years remain open for examination by the tax authorities under a four-year statute of limitations.

During 2014, the Company recorded a consolidated expense of \$17,896 in federal, state and local income taxes. At December 31, 2014, we had \$0 accrued for federal, state and local taxes payable by the Company.

We pay federal, state and local taxes primarily related to sublease income generated by Ventures, which is taxed as a C Corporation. For the years ended December 31, 2014, 2013, and 2012, our income tax expense for Ventures was \$16,968, \$27,053 and \$14,331, respectively.

Tax expense included in the Consolidated Statement of Operations consists of the following:

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

	2014	2013	2012
Current	\$17,896	\$27,994	\$15,236
Total income tax expense	\$17,896	\$27,994	\$15,236

165



The Company realized short- and long-term losses of \$5,899,525 in 2014. The Company realized short- and long-term capital gains of \$15,648,618 and \$2,421,669 in 2013 and 2012, respectively. The Company offsets these gains with capital loss carryforwards and neither owed federal income taxes on the gains nor was required to distribute any portion of the gains to shareholders.

On December 22, 2010, the Regulated Investment Company Modernization Act of 2010 (the "Act") was enacted, which changed various technical rules governing the tax treatment of RICs. The changes are generally effective for taxable years beginning after the date of enactment. One of the more prominent changes addresses capital loss carryforwards. Under the Act, the Company will be permitted to carry forward capital losses incurred in taxable years beginning after the date of enactment for an unlimited period. However, any losses incurred during those future taxable years will be required to be utilized prior to the losses incurred in pre-enactment taxable years, which carry an expiration date. As a result of this ordering rule, pre-enactment capital loss carryforwards may be more likely to expire unused. Additionally, post-enactment capital loss carryforwards will retain their character as either short-term or long-term capital losses rather than being considered all short term as permitted under previous regulation.

As of December 31, 2014, we had post-enactment loss carryforwards under the provisions of the Act of \$601,720 short term and \$5,297,805 long term. Post-enactment losses have no expiration date. As of December 31, 2014, we had pre-enactment loss carryforwards totaling \$3,875,967, expiring in 2018. We had no post-October losses.

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 11. COMMITMENTS AND CONTINGENCIES**

On July 21, 2014, the Company made a \$216,012 investment in Accelerator IV-New York Corporation ("Accelerator"). This initial investment was part of an overall \$666,667 operating commitment to Accelerator. Accelerator will be identifying emerging biotechnology companies for the Company to invest in directly. In addition to this operating commitment, the Company has a \$3,333,333 investment commitment to be invested in the identified portfolio companies over a five-year period. If the Company defaults on these commitments, the other investors may purchase the Company's shares of Accelerator for \$0.001 per share. In the event of default, the Company would still be required to contribute the remaining operating commitment.

The Company's aggregate operating and investment commitments in Accelerator amounted to \$666,667 and \$3,333,333, respectively. During the year ended December 31, 2014, \$216,012 in capital was called, all of which related to the operating commitment. As of December 31, 2014, the Company had remaining unfunded commitments

of \$450,655 and \$3,333,333, or approximately 67.6 percent and 100 percent, of the total operating and investment commitments, respectively. The withdrawal of contributed capital is not permitted. The transfer or assignment of capital is subject to approval by Accelerator.

On September 24, 2009, we signed a ten-year lease for approximately 6,900 square feet of office space located at 1450 Broadway, New York, New York. The lease commenced on January 21, 2010, with these offices replacing our corporate headquarters previously located at 111 West 57<sup>th</sup> Street in New York City. The base rent is \$36 per square foot with a 2.5 percent increase per year over the 10 years of the lease, subject to a full abatement of rent for four months and a rent credit for six months throughout the lease term. The lease expires on December 31, 2019.

We have one option to extend the lease term for a five-year period, provided that we are not in default under the lease. Annual rent during the renewal period will equal 95 percent of the fair market value of the leased premises, as determined in accordance with the lease. Upon an event of default, the lease provides that the landlord may terminate the lease and require us to pay all rent that would have been payable during the remainder of the lease or until the date the landlord re-enters the premises.

On July 1, 2008, we signed a five-year lease for office space at 420 Florence Street, Suite 200, Palo Alto, California, which commenced on August 1, 2008, and expired on August 31, 2013. On April 26, 2011, we signed a one-year lease for office space at 530 Lytton Avenue, 2<sup>nd</sup> Floor, Palo Alto, California, commencing on July 1, 2011, and expiring on June 30, 2012. The lease was renewed commencing on July 1, 2012, expiring on June 30, 2013, on July 1, 2013, expiring on June 30, 2014, and on July 1, 2014, expiring on June 30, 2015. On March 22, 2012, we signed a one-year lease for office space at 140 Preston Executive Drive, Space "L," Cary, North Carolina, commencing on April 1, 2012, and expiring on March 31, 2013. The lease was renewed commencing on April 1, 2013, and expired on March 31, 2014. On March 17, 2014, we signed a month-to-month lease for office space at 213 Fayetteville Street, Raleigh, North Carolina, commencing on March 24, 2014, through December 31, 2014. Total rent expense for all of our office space was \$299,048 in 2014; \$376,360 in 2013 and \$408,659 in 2012. Aggregate future minimum lease payments in each of the following years are: 2015 - \$301,096; 2016 - \$287,690; 2017 - \$294,882; 2018 - \$302,254; and 2019 - \$309,811.

In the ordinary course of business, we indemnify our officers and directors, subject to certain regulatory limitations, for loss or liability related to their service on behalf of the Company, including serving on the boards of directors or as officers of portfolio companies. At December 31, 2014, and 2013, we believed our estimated exposure was minimal, and accordingly we have no liability recorded.

#### **NOTE 12. CHANGE IN NET ASSETS PER SHARE**

The following table sets forth the computation of basic and diluted per share net decreases in net assets resulting from operations for the years ended December 31, 2014, 2013, and 2012.

	2014	2013	2012
Numerator for decrease in net assets per share	\$(13,570,420)	\$(7,788,958 )	\$(19,986,900)
Denominator for basic weighted average shares	31,222,877	31,138,716	31,000,919
Basic net decrease in net assets per share resulting from operations	\$(0.43 )	\$(0.25 )	\$(0.65 )
Denominator for diluted weighted average shares	31,222,877	31,138,716	31,000,919
Diluted net decrease in net assets per share resulting from operations <sup>1</sup>	\$(0.43 )	\$(0.25 )	\$(0.65 )
Anti-dilutive shares by type:			
Stock options	1,423,912	1,425,372	1,425,372
Restricted stock	268,705	436,518	548,000
Total anti-dilutive shares	1,692,617	1,861,890	1,973,372

<sup>1</sup>A total of 893,000, 1,068,000 and 1,068,000 market-based shares of restricted stock were outstanding at December 31, 2014, December 31, 2013, and December 31, 2012. These shares vest when the volume-weighted stock price is at or above pre-determined stock price targets over a 30-day period. These pre-determined stock price targets range from \$5.00 per share to \$9.00 per share. These shares were not included in the computation of diluted net asset value per share because as of the end of the reporting period none of the pre-determined stock price targets were met.

For the years ended December 31, 2014, 2013 and 2012, the calculation of net decrease in net assets resulting from operations per diluted share did not include stock options or shares of restricted stock because such shares were anti-dilutive. Stock options and restricted stock awards may be dilutive in future periods in which there are both a net increase in net assets resulting from operations and either significant increases in our average stock price or significant decreases in the amount of unrecognized compensation cost during the period.

### **NOTE 13. SUBSEQUENT EVENTS**

On January 21, 2015, the Company made a \$195,303 follow-on investment in Nantero, Inc., a privately held portfolio company.

On January 23, 2015, the Company made a \$500,000 follow-on investment in Produced Water Absorbents, Inc., a privately held portfolio company.

On January 29, 2015, the Company made a \$103,500 follow-on investment in SiOnyx, Inc., a privately held portfolio company.

On January 29, 2015, the Company made a \$262,215 follow-on investment in Accelerator IV-New York Corporation, a privately held portfolio company. This investment was made pursuant to our operating commitment of which \$188,440 remains unfunded. We continue to have an unfunded investment commitment of \$3,333,333.

On February 5, 2015, the Company made a \$250,000 new investment in Orig3n, Inc., a privately held portfolio company.

On February 5, 2015, the Company made a \$200,000 new investment in Phylagen, Inc., a privately held portfolio company.

On February 17, 2015, the Company made a \$484,203 follow-on investment in Produced Water Absorbents, Inc., a privately held portfolio company.

On February 17, 2015, the Company made a \$208,035 follow-on investment in OpGen, Inc., a privately held portfolio company.

On February 20, 2015, the Company made a \$104,521 follow-on investment in Mersana Therapeutics, Inc., a privately held portfolio company.

On March 2, 2015, the Company made a \$300,000 follow-on investment in Metabolon, Inc., a privately held portfolio company.

**NOTE 14. SELECTED QUARTERLY DATA (UNAUDITED)**

	2014			
	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	4 <sup>th</sup> Quarter
Total investment income	\$ 146,291	\$ 133,835	\$ 93,373	\$ 144,301
Net operating loss	\$(1,975,372)	\$(2,084,855)	\$(1,877,603)	\$(1,963,897)
Net (decrease) increase in net assets resulting from operations	\$(6,475,677)	\$ 4,328,055	\$(910,852)	\$(10,511,946)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$(0.21)	\$ 0.14	\$(0.03)	\$(0.33)

	2013			
	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter	4 <sup>th</sup> Quarter
Total investment income (loss)	\$ 185,090	\$ 189,963	\$ 135,025	\$ (39,176 )
Net operating loss	\$(1,935,573)	\$(1,989,938)	\$(1,892,794)	\$(2,203,901)
Net (decrease) increase in net assets resulting from operations	\$(2,060,192)	\$ 4,104,761	\$(2,096,162)	\$(7,737,365)
Net (decrease) increase in net assets resulting from operations per average outstanding share	\$(0.07 )	\$ 0.13	\$(0.07 )	\$(0.25 )

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

	Year Ended Dec. 31, 2014	Year Ended Dec. 31, 2013	Year Ended Dec. 31, 2012	Year Ended Dec. 31, 2011	Year Ended Dec. 31, 2010
<b>Per Share Operating Performance</b>					
Net asset value per share, beginning of year	\$3.93	\$4.13	\$4.70	\$4.76	\$4.35
Net operating loss*	(0.25 )	(0.26 )	(0.28 )	(0.27 )	(0.25 )
Net realized gain (loss) on investments*	(0.16 )	0.59	0.08	0.08	(0.12 )
Net (decrease) increase in unrealized appreciation on investments and written call options* <sup>(1)</sup>	(0.02 )	(0.58 )	(0.44 )	0.07	0.71
Total from investment operations*	(0.43 )	(0.25 )	(0.64 )	(0.12 )	0.34
Net increase as a result of stock-based compensation expense*	0.03	0.04	0.09	0.06	0.07
Net decrease as a result of acquisition of vested restricted stock awards related to employee withholding	(0.01 )	(0.01 )	(0.02 )	0.00	0.00
Total increase from capital stock transactions	0.02	0.03	0.07	0.06	0.07
Net increase as a result of other comprehensive income	(0.01 )	0.02	0.00	0.00	0.00
Net (decrease) increase in net asset value	(0.42 )	(0.20 )	(0.57 )	(0.06 )	0.41
	\$3.51	\$3.93	\$4.13	\$4.70	\$4.76



Net asset value per share, end of year										
Stock price per share, end of year	\$2.95		\$2.98		\$3.30		\$3.46		\$4.38	
Total return based on stock price	(1.01	)%	(9.70	)%	(4.62	)%	(21.0	)%	(4.16	)%
Supplemental Data:										
Net assets, end of year	\$109,654,427		\$122,701,575		\$128,436,774		\$145,698,407		\$146,853,912	
Ratio of expenses, excluding taxes, to average net assets	7.14	%	6.62	%	6.57	%	6.08	%	5.75	%
Ratio of expenses, including taxes, to average net assets	7.15	%	6.65	%	6.58	%	6.09	%	5.75	%
Ratio of net operating loss to average net assets	(6.70	)%	(6.26	)%	(6.07	)%	(5.61	)%	(5.43	)%
Average debt outstanding	\$0.00		\$0.00		\$1,679,781		\$1,254,247		\$0.00	
Average debt per share	\$0.00		\$0.00		\$0.05		\$0.04		\$0.00	
Cash dividends paid per share	\$0.00		\$0.00		\$0.00		\$0.00		\$0.00	
Taxes payable on behalf of shareholders on the deemed dividend per share	\$0.00		\$0.00		\$0.00		\$0.00		\$0.00	
Number of shares outstanding, end of year	31,280,843		31,197,438		31,116,881		31,000,601		30,878,164	

\*Based on average shares outstanding.

(1) Net unrealized gains (losses) include rounding adjustments to reconcile change in net asset value per share. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for a description of unrealized losses on investments.

The accompanying notes are an integral part of this schedule.



**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company's management, under the supervision and with the participation of our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as required by Rules 13a-15 of the Exchange Act). Disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the issuer's management, as appropriate, to allow timely decisions regarding required disclosures. As of December 31, 2014, based upon this evaluation of our disclosure controls and procedures, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective.

Internal Control Over Financial Reporting

Management's Report on Internal Control Over Financial Reporting and the Report of Independent Registered Public Accounting Firm, on the Company's internal control over financial reporting, is included in Item 8 of this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fourth quarter of 2014 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information.**

None.

171

## **PART III**

### **Item 10. Directors, Executive Officers and Corporate Governance.**

The information set forth under the captions "Nominees," "Executive Officers," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Audit Committee" in our Proxy Statement for the Annual Meeting of Shareholders to be held on June 5, 2015, to be filed pursuant to Regulation 14A under the Exchange Act (the "2015 Proxy Statement"), is herein incorporated by reference.

We have adopted a Code of Conduct for Directors and Employees, which also applies to our Chief Executive Officer, Chief Financial Officer, Treasurer and Senior Controller, which is posted on our website at <http://ir.hhvc.com/governance.cfm>.

The Board of Directors has determined that W. Dillaway Ayres, Jr., Stacy R. Brandom and Richard P. Shanley are all "Audit Committee Financial Experts" serving on our Audit Committee. Messrs. Ayres and Shanley and Ms. Brandom are not "interested persons" as defined under Section 2(a)(19) of the 1940 Act and are independent under the rules of the Nasdaq Stock Market.

### **Item 11. Executive Compensation.**

The information set forth under the captions "Executive Compensation," "Compensation Committee Interlocks and Insider Participation" and "Compensation Committee Report on Executive Compensation" in the 2015 Proxy Statement is herein incorporated by reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information set forth under the caption "How Many Shares Do the Company's Principal Shareholders, Directors and Executive Officers Own?" in the 2015 Proxy Statement is herein incorporated by reference. The "Equity Compensation Plan Information" chart is set forth herein under Item 5.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information set forth under the captions "Nominees" and "Related Party Transactions" in the 2015 Proxy Statement is herein incorporated by reference.

172

**Item 14. Principal Accountant Fees and Services.**

The information set forth under the captions "Audit Committee's Pre-Approval Policies" and "Fees Paid to PwC for 2014 and 2013" in the 2015 Proxy Statement is herein incorporated by reference.

PART IV

**Item 15. Exhibits and Financial Statements Schedules.**

(a) The following documents are filed as a part of this report:

(1) Listed below are the financial statements which are filed as part of this report:

- Consolidated Statements of Assets and Liabilities as of December 31, 2014, and 2013;
- Consolidated Statements of Operations for the years ended December 31, 2014, 2013, and 2012;
- Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2014, 2013, and 2012
- Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013, and 2012;
- Consolidated Statements of Changes in Net Assets for the years ended December 31, 2014, 2013, and 2012;
- Consolidated Schedule of Investments as of December 31, 2014;
- Consolidated Schedule of Investments as of December 31, 2013;
- Footnote to Consolidated Schedule of Investments;
- Notes to Consolidated Financial Statements; and
- Financial Highlights for the years ended December 31, 2014, 2013, 2012, 2011 and 2010.

(2) Schedule 12-14 – "Investments and Advances to Affiliates"

(3)



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

The following exhibits are filed with this report or are incorporated herein by reference to a prior filing, in accordance with Rule 12b-32 under the Exchange Act.

Restated Certificate of Incorporation of Harris & Harris Group, Inc., dated September 23, 2005, incorporated by 3.1(a) reference as Exhibit 3.1(a) to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 (File No. 814-00176) filed on March 15, 2011.

Certificate of Amendment of the Certificate of Incorporation of Harris & Harris Group, Inc., dated May 19, 3.1(b) 2006, incorporated by reference to Exhibit 3.1(b) to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (File No. 814-00176) filed on March 14, 2012.

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

3.2 Amended and Restated By-laws, incorporated by reference as Exhibit 3.1 to the Company's Form 8-K (File No. 814-00176) filed on August 3, 2012.

4\*

Form of Specimen Certificate of Common Stock.

Custody Agreement by and between Harris & Harris Group, Inc. and Union Bank, dated March 11, 2011, incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on March 14, 2011.

Custody Agreement by and between Harris & Harris Group, Inc. and TD Bank, N.A., dated February 24, 2011, incorporated by reference as Exhibit 10.2 to the Company's Form 8-K (File No. 814-00176) filed on February 24, 2011.

Multi-Draw Term Loan Facility Credit Agreement, by and among the Company, as borrower, Orix Corporate Capital, Inc., as Administrative Agent, and the other lenders party thereto from time to time, incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on September 30, 2013.

Form of Indemnification Agreement which has been established with all directors and executive officers of the Company, incorporated by reference as Exhibit 10.1 to the Company's Form 8-K (File No. 814-00176) filed on November 1, 2013.

Amended and Restated Harris & Harris Group, Inc. 2012 Equity Incentive Plan, incorporated by reference as Exhibit 10.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (File No. 814-00176) filed on March 14, 2012.

10.6\*

Form of Non-Qualified Stock Option Agreement.

Form of Director Restricted Stock Agreement, incorporated by reference as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 (File No. 814-00176) filed on May 10, 2012.

Form of Employee Restricted Stock Agreement, incorporated by reference as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 (File No. 814-00176) filed on May 10, 2012.



10.9\* Lease Agreement, dated September 24, 2009, between Rosh 1450 Properties LLC and Harris & Harris Group, Inc.

10.10 Harris & Harris Group, Inc. Employee Stock Purchase Plan, incorporated by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (File No. 814-00176) filed on March 14, 2012.

14.1\* Code of Conduct for Directors and Employees of Harris & Harris Group, Inc.

Subsidiaries of Registrant and Jurisdiction of Incorporation/Organization, incorporated by reference as Exhibit 21 to the Company's Annual Report on Form 10-K for the year ended December 31, 2012 (File No. 814-00176) filed on March 15, 2013.

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

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

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

---

\*Filed herewith

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HARRIS & HARRIS GROUP,  
INC.

Date: March 16, 2015 By: /s/ Douglas W. Jamison  
Douglas W. Jamison  
Chairman of the Board and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ Douglas W. Jamison Douglas W. Jamison	Chairman of the Board and Chief Executive Officer	March 16, 2015
/s/ Patricia N. Egan Patricia N. Egan	Chief Financial Officer	March 16, 2015
/s/ W. Dillaway Ayres, Jr. W. Dillaway Ayres, Jr.	Director	March 16, 2015
/s/ Phillip A. Bauman Phillip A. Bauman	Director	March 16, 2015
/s/ Stacy R. Brandom Stacy R. Brandom	Director	March 16, 2015
/s/ Charles E. Ramsey Charles E. Ramsey	Director	March 16, 2015
/s/ Richard P. Shanley Richard P. Shanley	Director	March 16, 2015

## EXHIBIT INDEX

The following exhibits are filed with this report in accordance with Rule 12b-32 under the Securities Exchange Act of 1934.

<b>Exhibit No.</b>	<b>Description</b>
4	Form of Specimen Certificate of Common Stock.
10.6	Form of Non-Qualified Stock Option Agreement.
10.9	Lease Agreement, dated September 24, 2009, between Rosh 1450 Properties LLC and Harris & Harris Group, Inc.
14.1	Code of Conduct for Directors and Employees of Harris & Harris Group, Inc.
31.01	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

178

**Schedule 12-14****HARRIS & HARRIS GROUP, INC.****INVESTMENTS IN AND ADVANCES TO AFFILIATES**

Name of Issuer	Title of Issue or Nature of Indebtedness <sup>(A)</sup>	Amount of		Gross Additions (C)	Gross Reductions (D)	Value as of December 31, 2013	Value as of December 31, 2014
		Dividends or Interest Credited  to Income (B)					
<b>MAJORITY OWNED CONTROLLED INVESTMENTS:</b>							
ProMuc, Inc.	Common Stock	\$ 0	\$ 1	\$ 0	\$ 0	\$ 1	
	Secured Convertible Bridge Note	31,091	351,074	131,090	0	482,164	
SynGlyco, Inc.	Common Stock	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	
	Secured Convertible Bridge Note	25,320	78,334	93,886	0	172,220	
	Series A' Convertible Preferred Stock	0	0	0	0	0	
	Senior Secured Debt	47,964	831,828	0	(11,709 )	820,119	
	Secured Convertible Bridge Note	30,105	91,389	113,374	0	204,763	
TARA Biosystems, Inc.	Common Stock	\$ 0	\$ 0	\$ 20	\$ 0	\$ 20	
		8,811	0	308,811	0	308,811	

Secured Convertible  
Bridge Note

Total Majority Owned Controlled Investments	\$ 143,291	\$ 1,352,626	\$ 647,181	\$(11,709 )	\$ 1,988,098
---	------------	--------------	------------	-------------	--------------

OTHER  
CONTROLLED  
INVESTMENTS:

Senova Systems, Inc.	Series B Convertible Preferred Stock	\$ 0	\$ 540,000	\$ 0	\$(136,877 )	\$ 403,123
-------------------------	---	------	------------	------	--------------	------------

	Series B-1 Convertible Preferred Stock	0	603,960	500,000	(204,773 )	899,187
--	---	---	---------	---------	------------	---------

	Series C Convertible Preferred Stock	8,287	0	609,349	0	609,349
--	---	-------	---	---------	---	---------

	Warrants for Series B Preferred Stock	0	75,750	0	(19,187 )	56,563
--	--	---	--------	---	-----------	--------

UberSeq, Inc.	Series Seed Convertible Preferred Stock	\$ 0	\$ 0	\$ 506,159	\$ 0	\$ 506,159
---------------	--	------	------	------------	------	------------

Total Other Controlled Investments	\$ 8,287	\$ 1,219,710	\$ 1,615,508	\$(360,837 )	\$ 2,474,381
--	----------	--------------	--------------	--------------	--------------



Name of Issuer	Title of Issue or Nature of Indebtedness <sup>(A)</sup>	Amount of		Gross Additions (C)	Gross Reductions (D)	Value as of December 31, 2014
		or Interest Credited  to Income (B)	Value as of December 31, 2013			
AFFILIATE INVESTMENTS:						
ABSMaterials, Inc.	Series A Convertible Preferred Stock	\$ 0	\$471,900	\$ 0	\$(180,025 )	\$291,875
	Series B Convertible Preferred Stock	0	755,679	500,038	0	1,255,717
Accelerator-New York Corporation	Series A Common stock	\$ 0	\$0	\$ 216,012	\$(164,385 )	\$51,627
Adesto Technologies Corporation	Series A Convertible Preferred Stock	\$ 0	\$ 1,388,276	\$ 264,333	\$ 0	\$ 1,652,609
	Series B Convertible Preferred Stock	0	1,262,070	265,387	0	1,527,457
	Series C Convertible Preferred Stock	0	449,963	182,563	0	632,526
	Series D Convertible Preferred Stock	0	1,070,067	0	(457,605 )	612,462
	Series D-1 Convertible Preferred Stock	0	561,291	0	(205,132 )	356,159
	Series E Convertible Preferred Stock	0	9,969,781	72,329	0	10,042,110
AgBiome, LLC	Series A-1 Convertible Preferred Stock	\$ 0	\$2,456,834	\$ 0	\$(50,624 )	\$2,406,210
	Series A-2 Convertible Preferred Stock	0	564,906	18,588	0	583,494

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

D-Wave Systems, Inc.	Series 1 Class B Convertible Preferred Stock	\$ 0	\$ 1,399,831	\$ 366,884	\$ 0	\$ 1,766,715
	Series 1 Class C Convertible Preferred Stock	0	550,765	148,692	0	699,457
	Series 1 Class D Convertible Preferred Stock	0	1,045,569	282,274	0	1,327,843
	Series 1 Class E Convertible Preferred Stock	0	329,249	106,011	0	435,260
	Series 1 Class F Convertible Preferred Stock	0	316,338	101,855	0	418,193
	Series 1 Class H Convertible Preferred Stock	2,869	0	935,480	(64,482 )	870,998
	Series 2 Class D Convertible Preferred Stock	0	829,313	223,892	0	1,053,205
	Series 2 Class E Convertible Preferred Stock	0	628,345	211,499	0	839,844

Name of Issuer	Title of Issue or Nature of Indebtedness <sup>(A)</sup>	Amount of		Value as of December 31, 2013	Gross Additions (C)	Gross Reductions (D)	Value as of December 31, 2014
		Dividends or Interest Credited to Income (B)					
D-Wave Systems, Inc. (Cont'd)	Series 2 Class F Convertible Preferred Stock	\$ 0		\$ 603,704	\$ 203,205	\$ 0	\$ 806,909
	Warrants for Common Stock	0		37,617	79,213	0	116,830
EchoPixel, Inc.	Series Seed Convertible Preferred Stock	\$ 0		\$ 750,000	\$ 562,425	\$ 0	\$ 1,312,425
Ensemble Therapeutics Corporation	Series B Convertible Preferred Stock	\$ 0		\$ 1,419,855	\$ 0	\$(359,832 )	\$ 1,060,023
	Series B-1 Convertible Preferred Stock <sup>(E)</sup>	12,535		2,679,932	0	(846,070 )	1,833,862
HZO, Inc.	Common Stock <sup>(F)</sup>	\$ 0		\$ 1,130,362	\$ 0	\$(807,530 )	\$ 322,832
	Series I Convertible Preferred Stock <sup>(F)</sup>	0		6,095,592	206,997	(1,820,492 )	4,482,097
	Series II Convertible Preferred Stock	0		0	2,113,002	0	2,113,002
Laser Light Engines, Inc.	Series A Convertible Preferred Stock	\$ 0		\$ 0	\$ 0	\$ 0	\$ 0
	Series B Convertible Preferred Stock	0		0	0	0	0
	Convertible Bridge Notes <sup>(G)</sup>	(1,392 )		164,122	33,076	(197,198 )	0
Metabolon, Inc.	Series B Convertible Preferred Stock	\$ 0		\$ 2,997,991	\$ 0	\$(216,617 )	\$ 2,781,374
		0		1,199,196	0	(40,542 )	1,158,654

	Series B-1 Convertible Preferred Stock					
	Series C Convertible Preferred Stock	0	2,756,500	0	(220,975 )	2,535,525
	Series D Convertible Preferred Stock	0	2,304,109	0	(124,485 )	2,179,624
	Series E Convertible Preferred Stock	0	1,225,000	331,847	0	1,556,847
	Warrants for Series B-1 Preferred Stock	0	216,408	268,127	0	484,535
OpGen, Inc.	Series A Convertible Preferred Stock	\$ 0	\$ 245,000	\$ 361,252	\$ 0	\$ 606,252
	Common Stock	0	0	22,752	0	22,752
	Convertible Bridge Notes	14,450	0	834,673	0	834,673

Name of Issuer	Title of Issue or Nature of Indebtedness <sup>(A)</sup>	Amount of				
		or Interest Credited to Income (B)	Value as of December 31, 2013	Gross Additions (C)	Gross Reductions (D)	Value as of December 31, 2014
Produced Water Absorbents, Inc.	Series A Convertible Preferred Stock	\$ 0	\$ 125,000	\$ 175,215	\$ 0	\$ 300,215
	Series B Convertible Preferred Stock	0	1,751,641	436,631	0	2,188,272
	Series B-2 Convertible Preferred Stock	0	0	1,579,844	0	1,579,844
	Series B-3 Convertible Preferred Stock	0	0	1,430,677	0	1,430,677
	Series C Convertible Preferred Stock	0	0	1,000,268	(245,138 )	755,130
	Warrants for Series B-2 Convertible Preferred Stock	0	0	65,250	(21,236 )	44,014
	Subordinated Secured Non-Convertible Debt	0	0	1,000,000	(20,550 )	979,450
Convertible Bridge Note	24,746	832,789	0	(832,789 )	0	
SiOnyx, Inc.	Series A Convertible Preferred Stock	\$ 0	\$ 43,781	\$ 0	\$(43,781 )	\$ 0
	Series A-1 Convertible Preferred Stock	0	556,250	0	(556,250 )	0
	Series A-2 Convertible Preferred Stock	0	788,913	0	(788,913 )	0
	Series B-1 Convertible Preferred Stock	0	451,903	0	(451,903 )	0

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

	Series C Convertible Preferred Stock	0	970,526	0	(970,526 )	0
	Warrants for Series B-1 Preferred Stock	0	18,165	0	(18,165 )	0
	Warrants for Common Stock	0	21,387	0	(21,387 )	0
	Secured Convertible Bridge Notes	6,144	1,719,458	584,754	(2,142,927 )	161,285
Ultora, Inc.	Series A Convertible Preferred Stock	\$ 0	\$ 1,788	\$ 0	\$(1,788 )	\$ 0
	Series B Convertible Preferred Stock	0	236,603	0	(236,603 )	0
	Unsecured Bridge Notes <sup>(G)</sup>	0	0	113,997	(113,997 )	0
	<b>Total Affiliate Investments</b>	<b>\$ 59,352</b>	<b>\$ 55,393,769</b>	<b>\$ 15,299,042</b>	<b>\$(12,221,947 )</b>	<b>\$ 58,470,864</b>

(A) Common stock, warrants, options, membership units and, in some cases, preferred stock are generally non-income producing and restricted. The principal amount of debt and the number of shares of common and preferred stock and number of membership units are shown in the accompanying *Consolidated Schedules of Investments* as of December 31, 2014 and 2013.

(B) Represents the total amount of interest or dividends credited to income for the portion of the year an investment was a control or affiliate investment, as appropriate. Amounts credited to preferred or common stock represent accrued bridge note interest related to conversions that occurred during 2014.

(C) Gross additions include increases in investments resulting from new portfolio investments, paid-in-kind interest or dividends, the amortization of discounts and fees. Gross additions also include net increases in unrealized appreciation or decreases in unrealized depreciation.

(D) Gross reductions include decreases in investments resulting from principal collections related to investment repayments or sales, the amortization of premiums and acquisition costs. Gross reductions also include net increases in unrealized depreciation or decreases in unrealized appreciation.

(E) During 2014, our secured convertible bridge notes plus accrued interest of Ensemble Therapeutics Corporation converted into shares of Series B-1 Convertible Preferred Stock.

(F) During 2014, our shares of Series A and Series B Convertible Preferred Stock of HZO, Inc., converted into shares of common stock and Series I Convertible Preferred Stock, respectively.

(G) Debt security is on non-accrual status and, therefore, is considered non-income producing during the year ended December 31, 2014.

\*\*Information related to the amount of equity in the net profit and loss for the year for the investments listed has not been included in this schedule. This information is not considered to be meaningful owing to the complex capital structures of the portfolio companies, with different classes of equity securities outstanding with different preferences in liquidation. These investments are not consolidated, nor are they accounted for under the equity method of accounting.