

HARRIS & HARRIS GROUP INC /NY/  
Form 10-Q  
May 09, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2016

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

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

Commission file number: 0-11576

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

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

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

(212) 582-0900

(Registrant's Telephone Number, Including Area Code)

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

Yes  No

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

Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

Yes  No

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

Class	Outstanding at May 9, 2016
Common Stock, \$0.01 par value per share	30,845,754 shares

Harris & Harris Group, Inc.

Form 10-Q, March 31, 2016

**Page Number**

**PART I. FINANCIAL INFORMATION**

<b><u>Item 1. Consolidated Financial Statements</u></b>	1
<u>Consolidated Statements of Assets and Liabilities</u>	2
<u>Consolidated Statements of Operations</u>	3
<u>Consolidated Statements of Comprehensive Loss</u>	4
<u>Consolidated Statements of Cash Flows</u>	5
<u>Consolidated Statements of Changes in Net Assets</u>	6
<u>Consolidated Schedule of Investments</u>	7
<u>Notes to Consolidated Financial Statements</u>	40
<u>Financial Highlights</u>	66

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** 67

<u>Cautionary Statement Regarding Forward-Looking Statements</u>	67
<u>Background</u>	68
<u>Overview</u>	68
<u>Current Business Environment</u>	76
<u>Valuation of Investments</u>	77
<u>Results of Operations</u>	82
<u>Financial Condition</u>	87
<u>Cash Flow</u>	88
<u>Liquidity and Capital Resources</u>	88
<u>Borrowings</u>	90
<u>Contractual Obligations</u>	90
<u>Critical Accounting Policies</u>	91
<u>Recent Developments – Portfolio Companies</u>	94

**Item 3. Quantitative and Qualitative Disclosures About Market Risk** 94

**Item 4. Controls and Procedures** 96

**PART II. OTHER INFORMATION** 98

**Item 1A. Risk Factors** 98

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds** 98

<u>Sales of Unregistered Equity Securities</u>	98
<u>Issuer Purchases of Equity Securities</u>	99
<b>Item 3. <u>Defaults Upon Senior Securities</u></b>	99
<b>Item 4. <u>Mine Safety Disclosures</u></b>	99
<b>Item 5. <u>Other Information</u></b>	100
<b>Item 6. <u>Exhibits</u></b>	100
<u>Signatures</u>	101
<u>Exhibit Index</u>	102
<b><u>Financial Statements Schedule 12-14</u></b>	i-v

## PART I. FINANCIAL INFORMATION

### **Item 1. Consolidated Financial Statements**

In the opinion of management, these financial statements reflect all adjustments, consisting of valuation adjustments and normal recurring accruals, necessary for a fair statement of our financial position, results of operations and cash flows for such periods.

Harris & Harris Group, Inc.<sup>®</sup> (the "Company," "us," "our" and "we"), is an internally managed, non-diversified management investment company that has elected to operate as a business development company ("BDC") under the Investment Company Act of 1940 (the "1940 Act"). Certain information and disclosures normally included in the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted as permitted by Regulation S-X and Regulation S-K. Accordingly, they do not include all information and disclosures necessary for a fair presentation of our financial position, results of operations and cash flows in conformity with GAAP. The results of operations for any interim period are not necessarily indicative of the results for the full year. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2015.

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

	March 31, 2016	December 31, 2015
<b>ASSETS</b>		
Investments, in portfolio securities at value:		
Unaffiliated privately held companies (cost: \$15,441,503 and \$18,857,235, respectively)	\$ 4,852,520	\$ 5,376,472
Unaffiliated rights to milestone payments (adjusted cost basis: \$781,863 and \$781,863, respectively)	2,959,769	3,362,051
Unaffiliated publicly traded securities (cost: \$1,623,029 and \$1,623,029, respectively)	944,423	957,544
Non-controlled affiliated privately held companies (cost: \$49,534,373 and \$49,262,921, respectively)	45,290,665	41,909,262
Non-controlled affiliated publicly traded companies (cost: \$23,165,788 and \$23,165,788, respectively)	13,361,800	18,371,105
Controlled affiliated privately held companies (cost: \$23,092,672 and \$23,205,336, respectively)	5,884,419	7,010,534
Equity method privately held company (adjusted cost basis: \$228,133 and \$165,936, respectively)	228,133	165,936
Total, investments in private portfolio companies, rights to milestone payments and public securities at value (cost: \$113,867,361 and \$117,062,108, respectively)	73,521,729	77,152,904
Cash	14,311,324	17,922,630
Funds held in escrow from sales of investments at value (Note 3)	633,921	374,565
Receivable from portfolio company	170,541	13,032
Interest receivable	13,433	10,333
Prepaid expenses	469,754	563,699
Other assets	412,668	424,123
Total assets	\$ 89,533,370	\$ 96,461,286
<b>LIABILITIES &amp; NET ASSETS</b>		
Term loan credit facility (Note 5)	\$ 5,000,000	\$ 5,000,000
Post retirement plan liabilities (Note 8)	1,212,433	1,202,148
Accounts payable and accrued liabilities	550,999	1,268,355
Deferred rent	264,693	279,112
Total liabilities	\$ 7,028,125	\$ 7,749,615
Commitments and contingencies (Note 11)		
Net assets	\$ 82,505,245	\$ 88,711,671

Net assets are comprised of:

Preferred stock, \$0.10 par value, 2,000,000 shares authorized; none issued	\$ 0	\$ 0
Common stock, \$0.01 par value, 45,000,000 shares authorized at 3/31/16 and 12/31/15; 33,183,576 issued at 3/31/16 and 12/31/15, respectively	331,836	331,836
Additional paid in capital (Note 9)	215,658,407	215,762,973
Accumulated net operating and realized loss	(88,990,815 )	(83,377,629 )
Accumulated unrealized depreciation of investments	(40,345,632 )	(39,909,204 )
Accumulated other comprehensive income (Note 8)	456,974	509,220
Treasury stock, at cost (2,337,822 shares at 3/31/16 and 12/31/15 (Note 12)	(4,605,525 )	(4,605,525 )
Net assets	\$ 82,505,245	\$ 88,711,671
Shares outstanding	30,845,754	30,845,754
Net asset value per outstanding share	\$ 2.67	\$ 2.88

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

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

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Investment income:		
Interest from:		
Unaffiliated companies	\$ 2,618	\$ 11,243
Non-controlled affiliated companies	56,066	52,426
Controlled affiliated companies	90,424	44,426
Cash and U.S. Treasury securities and other	1,432	1,430
Fees for providing managerial assistance to portfolio companies	146,877	7,000
Yield-enhancing fees on debt securities	4,625	26,307
Total investment income	302,042	142,832
Expenses:		
Salaries, benefits and stock-based compensation (Note 9)	603,908	1,078,489
Administration and operations	142,292	101,234
Professional fees	298,822	572,234
Rent (Note 3)	57,220	67,706
Insurance expense	59,575	67,611
Directors' fees and expenses	70,609	119,624
Interest and other debt expense	208,026	143,720
Custody fees	12,061	15,912
Depreciation	11,455	12,647
Total expenses	1,463,968	2,179,177
Net operating loss	(1,161,926	) (2,036,345
Net realized (loss) gain:		
Realized (loss) gain from investments:		
Unaffiliated companies	(3,158,993	) 10,485
Non-controlled affiliated companies	(1,244,955	) (293,786
Realized loss from investments	(4,403,948	) (283,301
Income tax expense (Note 10)	5,830	105
Net realized loss from investments	(4,409,778	) (283,406
Net (increase) decrease in unrealized depreciation on investments:		
Unaffiliated companies	2,891,779	(615,964
Controlled affiliated companies	(1,013,450	) 157,117



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

Unaffiliated rights to milestone payments	(402,282	)	916	
Non-controlled affiliated companies	3,109,951		(1,837,564	)
Publicly traded non-controlled affiliated companies	(5,009,305	)	0	
Publicly traded unaffiliated companies	(13,121	)	824,714	
Net increase in unrealized depreciation on investments	(436,428	)	(1,470,781	)
Net realized and unrealized loss on investments	(4,846,206	)	(1,754,187	)
Share of loss on equity method investment	(41,482	)	(131,506	)
Net decrease in net assets resulting from operations:				
Total	\$ (6,049,614	)	\$ (3,922,038	)
Per average basic and diluted outstanding share	\$ (0.20	)	\$ (0.13	)
Average outstanding shares - basic and diluted	30,845,754		31,280,843	

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

**HARRIS & HARRIS GROUP, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

**(Unaudited)**

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Net decrease in net assets resulting from operations	\$ (6,049,614	) \$ (3,922,038
Other comprehensive loss:		
Amortization of prior service cost	(52,246	) (52,246
Other comprehensive loss	(52,246	) (52,246
Comprehensive loss	\$ (6,101,860	) \$ (3,974,284

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

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

	Three Months Ended March 31, 2016	Three Months Ended March 31, 2015
Cash flows used in operating activities:		
Net decrease in net assets resulting from operations	\$ (6,049,614	) \$ (3,922,038
Adjustments to reconcile net decrease in net assets resulting from operations to net cash used in operating activities:		
Net realized loss and change in unrealized depreciation on investments	4,840,376	1,754,082
Depreciation of fixed assets, amortization of prepaid assets and accretion of bridge note interest	(108,842	) (66,312
Share of loss on equity method investment	41,482	131,506
Stock-based compensation (benefit) expense	(104,566	) 212,591
Amortization of prior service cost	(52,246	) (52,246
Funding of operating commitment to equity method investment	(103,680	) (262,215
Purchase of affiliated portfolio companies	(2,150,012	) (1,853,262
Purchase of unaffiliated portfolio companies	0	(499,824
Payments received on debt investments	0	91,736
Proceeds from sale of investments and repayment of bridge notes	863,950	24,000
Changes in assets and liabilities:		
Receivable from portfolio companies	(157,509	) (9,933
Interest receivable	(3,100	) 13,948
Prepaid expenses	93,945	60,524
Other assets	0	378
Post retirement plan liabilities	10,285	13,371
Accounts payable and accrued liabilities	(717,356	) (313,699
Deferred rent	(14,419	) (12,672
Net cash used in operating activities	(3,611,306	) (4,690,065
Cash flows from investing activities:		
Purchase of fixed assets	0	(6,806
Net cash used in investing activities	0	(6,806
Cash flows from financing activities:		
Proceeds from drawdown of loan facility	0	5,000,000
Net cash provided by financing activities	0	5,000,000
Net (decrease) increase in cash	\$ (3,611,306	) \$ 303,129

Cash at beginning of the period	17,922,630	20,748,314
Cash at end of the period	\$ 14,311,324	\$ 21,051,443

Supplemental disclosures of cash flow information:

Income taxes paid	\$ 5,830	\$ 105
Interest paid	\$ 126,389	\$ 0

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

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

	Three Months Ended March 31, 2016	Year Ended December 31, 2015
Changes in net assets from operations:		
Net operating loss	\$ (1,161,926	) \$ (7,162,510
Net realized (loss) gain on investments	(4,409,778	) 4,531,700
Net increase in unrealized depreciation on investments	(436,428	) (17,302,729
Share of loss on equity method investment	(41,482	) (312,291
Net decrease in net assets resulting from operations	(6,049,614	) (20,245,830
Changes in net assets from capital stock transactions:		
Purchase of treasury stock	0	(1,199,994
Acquisition of vested restricted stock awards to pay required employee withholding tax	0	(86,914
Stock-based compensation (benefit) expense	(104,566	) 798,965
<b>Net decrease in net assets resulting from capital stock transactions</b>	(104,566	) (487,943
Changes in net assets from accumulated other comprehensive loss:		
Other comprehensive loss	(52,246	) (208,983
<b>Net decrease in net assets resulting from accumulated other comprehensive loss</b>	(52,246	) (208,983
Net decrease in net assets	(6,206,426	) (20,942,756
Net Assets:		
Beginning of the period	88,711,671	109,654,427
End of the period	\$ 82,505,245	\$ 88,711,671

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

6

HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016****(Unaudited)**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 10.6% of net assets at value					
Private Placement Portfolio (Illiquid) (4) – 5.9% of net assets at value					
Bridgelux, Inc. (5)(8)(9)(10)					
Manufacturing high-power light emitting diodes (LEDs) and arrays					
Series B Convertible Preferred Stock (acquired 11/29/07)	(M)	Energy	\$1,000,000	1,861,504	\$185,847
Series C Convertible Preferred Stock (acquired 7/27/07)	(M)		1,352,196	2,130,699	383,598
Series D Convertible Preferred Stock (acquired 2/25/08-3/10/10)	(M)		1,371,622	999,999	528,700
Series E Convertible Preferred Stock (acquired 6/1/11)	(M)		672,599	440,334	435,848
Series E-1 Convertible Preferred Stock (acquired 3/16/12)	(M)		386,073	399,579	287,397
Warrants for Series E Convertible Preferred Stock expiring 12/31/17 (acquired 1/27/11)	(M)		93,969	170,823	0
Warrants for Common Stock expiring 6/1/16 (acquired 6/1/11)	(M)		72,668	132,100	0
Warrants for Common Stock expiring 8/9/18 (acquired 8/9/13)	(M)		148,409	171,183	0
Warrants for Common Stock expiring 10/21/18 (acquired 10/21/11)	(M)		18,816	84,846	0
			5,116,352		1,821,390
Magic Leap, Inc. (8)(9)(11)					
Developing novel human computing interfaces and software					
Series B Convertible Preferred Stock (acquired 5/1/15)	(M)	Electronics	338,604	29,291	624,059
Mersana Therapeutics, Inc. (5)(8)(9)					
Life Sciences					

Developing antibody drug conjugates  
for cancer therapy

Series A-1 Convertible Preferred Stock (acquired 7/27/12-4/2/14)	(H)	683,538	635,081	614,748
Series B-1 Convertible Preferred Stock (acquired 2/20/15)	(H)	104,521	97,111	105,035
Common Stock (acquired 7/27/12)	(H)	3,875,395	350,539	308,007
		4,663,454		1,027,790

Nanosys, Inc. (5)(8)(9)

Energy

Developing inorganic nanowires and  
quantum dots for use in LED-backlit devices

Series C Convertible Preferred Stock (acquired 4/10/03)	(M)	1,500,000	803,428	91,833
Series D Convertible Preferred Stock (acquired 11/7/05)	(M)	3,000,003	1,016,950	483,682
Series E Convertible Preferred Stock (acquired 8/13/10)	(M)	496,573	433,688	424,364
		4,996,576		999,879

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



HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016****(Unaudited)**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 10.6% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) – 5.9% of net assets at value (Cont.)					
Nano Terra, Inc. (5)(8) Developing surface chemistry and nano- manufacturing solutions		Energy			
Warrants for Common Stock expiring on 2/22/21 (acquired 2/22/11)	(M)		\$69,168	4,462	\$1,218
Warrants for Series A-3 Preferred Stock expiring on 11/15/22 (acquired 11/15/12)	(M)		35,403	47,508	67,459
			104,571		68,677
Phylagen, Inc. (5)(8) Developing technology to improve human health and business productivity		Life Sciences			
Secured Convertible Bridge Note, 5%, (acquired 2/5/15)	(M)		211,534	\$200,000	296,148
Secured Convertible Bridge Note, 5%, (acquired 6/5/15)	(M)		10,412	\$10,000	14,577
			221,946		310,725
Total Unaffiliated Private Placement Portfolio (cost: \$15,441,503)					\$4,852,520
Rights to Milestone Payments (Illiquid) (6) – 3.6% of net assets at value					
Amgen, Inc. (8)(9) Rights to Milestone Payments from Acquisition of BioVex Group, Inc. (acquired 3/4/11)	(I)	Life Sciences	\$548,998	\$548,998	\$2,495,696
Laird Technologies, Inc. (8)(9)	(I)	Energy	0	\$0	0

Rights to Milestone Payments from Merger &  
Acquisition of Nextreme Thermal Solutions, Inc.  
(acquired 2/13/13)

Canon, Inc. (8)(9)	Electronics			
Rights to Milestone Payments from Acquisition of Molecular Imprints, Inc. (acquired (I) 4/18/14)		232,865	\$232,865	464,073
Total Unaffiliated Rights to Milestone Payments (cost: \$781,863)				\$2,959,769

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

HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016****(Unaudited)**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Publicly Traded Portfolio (7) – 1.1% of net assets at value					
Champions Oncology, Inc. (5)(9)		Life Sciences			
Developing its TumorGraft™ platform for personalized medicine and drug development Common Stock (acquired 3/24/11-3/11/15)	(M)		\$1,622,629	243,540	\$933,232
Warrants for Common Stock expiring 1/28/19 (acquired 1/28/13)	(I)		400	5,500	11,191
			1,623,029		944,423
Total Unaffiliated Publicly Traded Portfolio (cost: \$1,623,029)					\$944,423
Total Investments in Unaffiliated Companies (cost: \$17,846,395)					\$8,756,712
Investments in Non-Controlled Affiliated Companies (3) – 71.1% of net assets at value					
Private Placement Portfolio (Illiquid) (13) – 54.9% of net assets at value					
ABSMaterials, Inc. (5)(8)(9)		Energy			
Developing nano-structured absorbent materials for water remediation and consumer applications Series A Convertible Preferred Stock (acquired 2/17/10-10/24/11)	(I)		\$435,000	390,000	\$180,984
Series B Convertible Preferred Stock (acquired 11/8/13-6/25/14)	(I)		1,217,644	1,037,751	822,698
Secured Convertible Bridge Note, 8%, (acquired 1/20/16)	(M)		101,578	\$100,000	101,578
			1,754,222		1,105,260
AgBiome, LLC (5)(8)(9)		Life Sciences			

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 (acquired 1/30/13)	( I )	2,000,000	2,000,000	4,147,607
Series A-2 Convertible Preferred Stock (acquired 4/9/13-10/15/13)	( I )	521,740	417,392	921,590
Series B Convertible Preferred Stock (acquired 8/7/15)	( I )	500,006	160,526	586,320
		3,021,746		5,655,517

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

HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016****(Unaudited)**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 71.1% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (13) – 54.9% of net assets at value (Cont.)					
D-Wave Systems, Inc. (5)(8)(9)(14) Developing high-performance quantum computing systems		Electronics			
Series 1 Class B Convertible Preferred Stock (acquired 9/30/08)	(H)		\$1,002,074	1,144,869	\$2,518,309
Series 1 Class C Convertible Preferred Stock (acquired 9/30/08)	(H)		487,804	450,450	996,826
Series 1 Class D Convertible Preferred Stock (acquired 9/30/08)	(H)		748,473	855,131	1,892,367
Series 1 Class E Convertible Preferred Stock (acquired 11/24/10)	(H)		248,049	269,280	608,102
Series 1 Class F Convertible Preferred Stock (acquired 11/24/10)	(H)		238,323	258,721	584,257
Series 1 Class H Convertible Preferred Stock (acquired 6/27/14)	(H)		909,088	460,866	1,141,620
Series 2 Class D Convertible Preferred Stock (acquired 9/30/08)	(H)		736,019	678,264	1,500,968
Series 2 Class E Convertible Preferred Stock (acquired 6/1/12-3/22/13)	(H)		659,493	513,900	1,170,770
Series 2 Class F Convertible Preferred Stock (acquired 6/1/12-3/22/13)	(H)		633,631	493,747	1,124,857
Warrants for Common Stock expiring 5/12/19 (acquired 5/12/14)	(I)		26,357	20,415	1,071
			5,689,311		11,539,147
EchoPixel, Inc. (5)(8) Developing virtual reality 3-D visualization software for life sciences and health care applications		Life Sciences			

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

Series Seed Convertible Preferred Stock (acquired 6/21/13-6/30/14)	(I)	1,250,000	4,194,630	1,335,447
Series Seed-2 Convertible Preferred Stock (acquired 1/22/16)	(I)	500,000	1,476,668	503,612
		1,750,000		1,839,059
Ensemble Therapeutics Corporation (5)(8)(9)				
Developing DNA-Programmed Chemistry™ for the discovery of new classes of therapeutics				
Series B Convertible Preferred Stock (acquired 6/6/07)	(I)	2,000,000	1,449,275	704,660
Series B-1 Convertible Preferred Stock (acquired 4/21/14)	(I)	679,754	492,575	1,440,730
		2,679,754		2,145,390
HZO, Inc. (5)(8)(9)				
Developing novel industrial coatings that protect electronics against damage from liquids				
Common Stock (acquired 6/23/14)	(I)	666,667	405,729	359,994
Series I Convertible Preferred Stock (acquired 6/23/14)	(I)	5,709,835	2,266,894	4,486,681
Series II Convertible Preferred Stock (acquired 6/23/14-8/3/15)	(I)	2,500,006	674,638	2,571,646
		8,876,508		7,418,321

Life  
Sciences

Electronics

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

HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016**

(Unaudited)

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 71.1% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (13) – 54.9% of net assets at value (Cont.)					
Laser Light Engines, Inc. (8)(9) Manufactured solid-state light sources for digital cinema and large-venue projection displays		Energy			
Series A Convertible Preferred Stock (acquired 5/6/08)	(M)		\$2,000,000	7,499,062	\$0
Series B Convertible Preferred Stock (acquired 9/17/10)	(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

Lodo Therapeutics Corporation (5)(8)(9)					Life Sciences
Developing and commercializing novel therapeutics derived from a metagenome-based Natural Product Discovery Platform					
Series A Convertible Preferred Stock (acquired 12/21/15)	( I )	107,900	107,900	107,835	
Metabolon, Inc. (5)(8)(9)					Life Sciences
Developing a biochemical profiling platform for precision medicine					
Series B Convertible Preferred Stock (acquired 6/29/09)	(M)	2,500,000	371,739	2,957,498	
Series B-1 Convertible Preferred Stock (acquired 6/29/09)	(M)	706,214	148,696	1,182,998	
Series C Convertible Preferred Stock (acquired 4/30/09)	(M)	1,000,000	1,000,000	2,711,294	
Series D Convertible Preferred Stock (acquired 8/25/11)	(M)	1,499,999	835,882	2,359,499	
Series E-1 Convertible Preferred Stock (acquired 3/2/15)	(M)	1,225,000	444,404	1,534,395	
Series E-2 Convertible Preferred Stock (acquired 3/2/15)	(M)	299,999	103,277	332,387	
		7,231,212		11,078,071	
ORIG3N, Inc. (5)(8)(9)					Life Sciences
Developing precision medicine applications for induced pluripotent stems cells					
Series 1 Convertible Preferred Stock (acquired 2/5/15-8/5/15)	( I )	500,000	1,195,315	827,622	
Series A Convertible Preferred Stock (acquired 11/25/15)	( I )	750,000	682,333	747,943	
		1,250,000		1,575,565	

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



HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016**

(Unaudited)

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Non-Controlled Affiliated Companies (3) – 71.1% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (13) – 54.9% of net assets at value (Cont.)					
Petra Pharma Corporation (5)(8)(9)		Life Sciences			
Developing small molecule inhibitors for treatment of cancer and metabolic diseases Series A Convertible Preferred Stock (acquired 12/23/15)	(I)		\$1,025,050	1,025,050	\$1,023,535
Produced Water Absorbents, Inc. (5)(8)(15)		Energy			
Providing integrated process separation solutions to the global oil and gas industries, enabling onsite treatment of produced and flowback water Series A Convertible Preferred Stock (acquired 6/21/11)	(M)		1,000,000	1,000,000	23,123
Series B Convertible Preferred Stock (acquired 6/20/13-3/31/14)	(M)		1,496,865	5,987,460	63,900
Series B-2 Convertible Preferred Stock (acquired 5/12/14)	(M)		1,015,427	4,322,709	46,133
Series B-3 Convertible Preferred Stock (acquired 11/14/13)	(M)		978,641	3,914,564	41,777
Series C Convertible Preferred Stock (acquired 5/26/14)	(M)		1,000,268	2,667,380	22,536
Series D Convertible Preferred Stock (acquired 2/17/15)	(M)		986,066	2,629,510	39,756
Subordinated Secured Debt, 12%, maturing on 6/30/16 (acquired 10/7/14)	(M)		995,259	\$1,000,000	570,491
Subordinated Convertible Bridge Note, 12%, (acquired 6/3/15)	(M)		273,096	\$250,000	27,526
	(M)		269,644	\$250,000	27,179

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

Subordinated Convertible Bridge Note, 12%, (acquired 7/15/15)				
Subordinated Convertible Bridge Note, 12%, (acquired 9/28/15)	(M)	263,479	\$250,000	26,557
Subordinated Convertible Bridge Note, 12%, (acquired 10/30/15)	(M)	260,849	\$250,000	26,292
Subordinated Convertible Bridge Note, 12%, (acquired 2/16/16)	(M)	125,945	\$125,000	12,695
Warrants for Series B-2 Preferred Stock expiring upon liquidation event (acquired 5/12/14)	(I)	65,250	300,000	0
Senior Secured Debt, 15% commencing on 4/1/16, maturing on 12/31/19 (acquired 3/9/16)	(M)	875,000	\$875,000	875,000
		9,605,789		\$1,802,965
Total Non-Controlled Private Placement Portfolio (cost: \$49,534,373)				\$45,290,665

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

## HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016**

(Unaudited)

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Publicly Traded Portfolio (16) – 16.2% of net assets at value					
Adesto Technologies Corporation (5)(8)(9)(17) Developing low-power, high-performance memory devices		Electronics			
Common Stock (acquired 10/27/15)	(M)		\$ 11,482,417	1,769,868	\$ 9,946,658
Enumeral Biomedical Holdings, Inc. (5)(9)(18) Developing therapeutics and diagnostics through functional assaying of single cells		Life Sciences			
Common Stock (acquired 7/31/14)	(M)		4,993,357	7,966,368	1,274,619
Warrants for Common Stock expiring 7/30/19 (acquired 7/31/14)	(I)		540,375	1,500,000	22,563
Warrants for Common Stock expiring 2/2/24 (acquired 7/31/14)	(I)		57,567	255,120	29,540
Options to Purchase Common Stock at \$1.00 expiring 7/30/16 (acquired 8/4/14)	(I)		0	80,000	0
			5,591,299		1,326,722
OpGen, Inc. (5)(9)(19) Developing tools for genomic sequence assembly and analysis		Life Sciences			
Common Stock (acquired 5/5/15)	(M)		5,665,708	1,409,796	1,987,812
Warrants for Common Stock expiring 5/8/20 (acquired 5/5/15)	(M)		425,579	300,833	73,317
Warrants for Common Stock expiring 2/17/25 (acquired 5/5/15)	(I)		785	31,206	27,291
			6,092,072		2,088,420
Total Non-Controlled Affiliated Publicly Traded Portfolio (cost: \$23,165,788)					\$ 13,361,800
Total Investments in Non-Controlled Affiliated Companies (cost: \$72,700,161)					\$ 58,652,465

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

## HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016****(Unaudited)**

	<b>Method of</b>	<b>Primary</b>		<b>Shares/</b>	
	<b>Valuation (1)</b>	<b>Industry (2)</b>	<b>Cost</b>	<b>Principal</b>	<b>Value</b>
Investments in Controlled Affiliated Companies (3) – 7.1% of net assets at value					
Private Placement Portfolio (Illiquid) (20) – 7.1% of net assets at value					
Black Silicon Holdings, Inc. (5)(8)(21)					
Holding company for interest in a company that develops silicon-based optoelectronic products					
Series A Convertible Preferred Stock (acquired 8/4/15)					
( I )		Electronics	\$750,000	233,499	\$0
Series A-1 Convertible Preferred Stock (acquired 8/4/15)					
( I )			890,000	2,966,667	0
Series A-2 Convertible Preferred Stock (acquired 8/4/15)					
( I )			2,445,000	4,207,537	0
Series B-1 Convertible Preferred Stock (acquired 8/4/15)					
( I )			1,169,561	1,892,836	0
Series C Convertible Preferred Stock (acquired 8/4/15)					
( I )			1,171,316	1,674,030	0
Secured Convertible Bridge Note, 8%, (acquired 8/4/15)					
( I )			1,346,922	\$1,278,454	322,123
			7,772,799		322,123
Interome, Inc. (5)(8)(12)					
Developing human tissue models for toxicology and drug discovery applications					
Common Stock (acquired 3/1/16)					
(M)		Life Sciences	10	1,000,000	10
Secured Convertible Bridge Note, 12%, (acquired 3/1/16)					
(M)			300,000	\$300,000	300,000
			300,010		300,010
NGX Bio, Inc. (5)(8)(9)(22)					
Developing translational genomics solutions					
( I )		Life Sciences	500,002	666,667	495,818

Series Seed Convertible Preferred Stock (acquired 6/6/14-1/10/16)				
Series A Convertible Preferred Stock (acquired 8/20/15-9/30/15)	( I )	499,999	329,989	339,761
		1,000,001		835,579
ProMuc, Inc. (5)(8)				
			Life Sciences	
Developing synthetic mucins for the nutritional, food and health care markets				
Common Stock (acquired 12/18/13)	(M)	1	1,000	1
Secured Convertible Bridge Note, 8%, (acquired 12/18/13)	(M)	414,055	\$ 350,000	414,055
Secured Convertible Bridge Note, 8%, (acquired 8/13/14)	(M)	113,085	\$ 100,000	113,085
Secured Convertible Bridge Note, 8%, (acquired 8/5/15)	(M)	78,945	\$ 75,000	78,945
Secured Convertible Bridge Note, 8%, (acquired 12/7/15)	(M)	56,398	\$ 55,000	56,398
		662,484		662,484

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

## HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016****(Unaudited)**

	<b>Method of</b>	<b>Primary</b>		<b>Shares/</b>	
	<b>Valuation (1)</b>	<b>Industry (2)</b>	<b>Cost</b>	<b>Principal</b>	<b>Value</b>
Investments in Controlled Affiliated Companies (3) – 7.1% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (20) – 7.1% of net assets at value (Cont.)					
Senova Systems, Inc. (5)(8)(9)		Life Sciences			
Developing next-generation sensors to measure pH					
Series B Convertible Preferred Stock (acquired 9/9/11-7/18/12)	(I)		\$1,218,462	1,350,000	\$110,357
Series B-1 Convertible Preferred Stock (acquired 8/1/13-1/15/14)	(I)		1,083,960	2,759,902	225,611
Series C Convertible Preferred Stock (acquired 10/24/14-4/1/15)	(I)		1,208,287	1,611,049	938,014
Secured Convertible Bridge Note, 10%, (acquired 1/15/16)	(I)		255,274	\$250,000	255,274
Warrants for Series B Preferred Stock expiring 10/15/17 (acquired 10/15/12)	(I)		131,538	164,423	13,441
Warrants for Series B Preferred Stock expiring 4/24/18 (acquired 4/24/13)	(I)		20,000	25,000	2,044
			3,917,521		1,544,741
SynGlyco, Inc. (5)(8)		Life Sciences			
Developed synthetic carbohydrates for pharmaceutical applications					
Common Stock (acquired 12/13/11)	(I)		2,729,817	57,463	0
Series A' Convertible Preferred Stock (acquired 12/13/11-6/7/12)	(I)		4,855,627	4,855,627	88,088
Secured Convertible Bridge Note, 8%, (acquired 1/23/13)	(I)		68,344	\$67,823	68,344
			7,653,788		156,432
TARA Biosystems, Inc. (5)(8)					

Life  
Sciences

Developing human tissue models for toxicology and drug discovery applications				
Common Stock (acquired 8/20/14)	(M)	20	2,000,000	20
Secured Convertible Bridge Note, 8%, (acquired 8/20/14)	(M)	339,978	\$ 300,000	509,967
Secured Convertible Bridge Note, 8%, (acquired 5/18/15)	(M)	213,983	\$ 200,000	320,975
Secured Convertible Bridge Note, 8%, acquired 12/1/15	(M)	1,232,088	\$ 1,200,000	1,232,088
		1,786,069		2,063,050
Total Controlled Private Placement Portfolio (cost: \$23,092,672)				\$5,884,419
Total Investments in Controlled Affiliated Companies (cost: \$23,092,672)				\$5,884,419
Total Private Placement and Publicly Traded Portfolio (cost: \$113,639,228)				\$73,293,596

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



HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016****(Unaudited)**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Equity Method Investments (23) – 0.3% of net assets at value					
Private Placement Portfolio (Illiquid) (23) – 0.3% of net assets at value					
Accelerator IV-New York Corporation (8)(9)(24) Identifying and managing emerging biotechnology companies Series A Common Stock (acquired 7/21/14-1/29/16)	(E)	Life Sciences	\$ 228,133	581,907	\$ 228,133
Total Equity Method Investments (cost: \$228,133)					\$ 228,133
Total Investments (cost: \$113,867,361)					\$ 73,521,729

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

HARRIS & HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016**

(Unaudited)

Notes to Consolidated Schedule of Investments

(1) See "Footnote to Consolidated Schedule of Investments" on page 34 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 and computing. We classify "Life Sciences" companies as those that address problems in life sciences-related industries, including precision health and precision medicine, biotechnology, agriculture, advanced materials and chemicals, health care, 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, including control of a majority of the seats on the board of directors, or more than 25 percent of the seats on the board of directors, with no other entity or person in control of more director seats than us. Among our controlled affiliated companies, ProMuc, Inc., and Interome, Inc., were 100 percent owned by us at March 31, 2016.

The aggregate cost for federal income tax purposes of investments in unaffiliated privately held companies is \$15,441,503. The gross unrealized appreciation based on the tax cost for these securities is \$374,234. The gross unrealized depreciation based on the tax cost for these securities is \$10,963,217.

(5) All or a portion of the investments or instruments are pledged as collateral under our Loan Facility with Orix Corporate Capital, Inc.

(6) The aggregate cost for federal income tax purposes of investments in unaffiliated rights to milestone payments is \$781,863. The gross unrealized appreciation based on the tax cost for these securities is \$2,177,906. 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 (7) \$1,623,029. 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 \$678,606.

(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.

On July 21, 2015, Bridgelux, Inc., signed a definitive agreement to be acquired by an investment group led by (10) China Electronics Corporation and ChongQing Linkong Development Investment Company. The close of this transaction remains pending as of March 31, 2016.

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

HARRIS & HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016**

(Unaudited)

We received our shares of Magic Leap, Inc., as part of the consideration paid for one of our portfolio companies (11) in an acquisition during the second quarter of 2015. A total of 4,394 shares of our 29,291 shares of Magic Leap are held in escrow to satisfy indemnity claims through May 1, 2016.

(12) Initial investment was made in 2016.

The aggregate cost for federal income tax purposes of investments in non-controlled affiliated privately held (13) companies is \$49,534,373. The gross unrealized appreciation based on the tax cost for these securities is \$12,745,089. The gross unrealized depreciation based on the tax cost for these securities is \$16,988,797.

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 (14) to foreign currency translation. See "Note 3. 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.

Produced Water Absorbents, Inc., also does business as ProSep, Inc. On April 1, 2016, the Company's (15) Subordinated Secured Note was reissued as a Senior Secured Note with the same terms as the Senior Secured Note purchased in the first quarter of 2016.

(16) The aggregate cost for federal income tax purposes of investments in non-controlled affiliated publicly traded companies is \$23,165,788. 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 \$9,803,988.

As of March 31, 2016, the Company's shares of Adesto Technologies Corporation were subject to a lock-up agreement that restricted our ability to trade these securities. The lock-up agreement expired on April 25, 2016. A (17) total of 200,000 shares are not qualifying assets 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.

(18) As of December 31, 2015, a portion of the Company's shares and warrants of Enumeral Biomedical Holdings, Inc., were subject to a lock-up agreement that restricts our ability to trade these securities. The lock-up period on

our securities of Enumeral Biomedical Holdings expired on January 31, 2016.

A total of 300,833 shares and 300,833 warrants are not qualifying assets under Section 55(a) of the 1940 Act.  
(19) 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.

The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is  
(20) \$23,092,672. The gross unrealized appreciation based on the tax cost for these securities is \$276,981. The gross unrealized depreciation based on the tax cost for these securities is \$17,485,234.

On August 4, 2015, SiOnyx, Inc., reorganized its corporate structure to become a subsidiary of a new company, Black Silicon Holdings, Inc. Our security holdings of SiOnyx converted into securities of Black Silicon  
(21) Holdings. SiOnyx was then acquired by an undisclosed buyer. Black Silicon Holdings owns a profit interest in the undisclosed buyer.

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

HARRIS & HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF MARCH 31, 2016**

**(Unaudited)**

(22) On August 19, 2015, UberSeq, Inc., changed its name to NGX Bio, Inc.

The aggregate cost for federal income tax purposes of investments in privately held equity method investments is (23) \$228,133. Under the equity method, investments are carried at cost, plus or minus the Company's equity in the increases and decreases in the investee's net assets after the date of acquisition and certain other adjustments.

(24) 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."

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

HARRIS &amp; HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	V
Investments in Unaffiliated Companies (3) – 11.0% of net assets at value					
Private Placement Portfolio (Illiquid) (4) – 6.1% of net assets at value					
Bridgelux, Inc. (5)(8)(9)(10)					
Manufacturing high-power light emitting diodes (LEDs) and arrays					
		Energy			
Series B Convertible Preferred Stock (acquired 11/29/07)	(M)		\$1,000,000	1,861,504	\$
Series C Convertible Preferred Stock (acquired 7/27/07)	(M)		1,352,196	2,130,699	
Series D Convertible Preferred Stock (acquired (2/25/08-3/10/10)	(M)		1,371,622	999,999	
Series E Convertible Preferred Stock (acquired 6/1/11)	(M)		672,599	440,334	
Series E-1 Convertible Preferred Stock (acquired 3/16/12)	(M)		386,073	399,579	
Warrants for Series E Convertible Preferred Stock expiring 12/31/17 (acquired 1/27/11)	(M)		93,969	170,823	
Warrants for Common Stock expiring 6/1/16 (acquired 6/1/11)	(M)		72,668	132,100	
Warrants for Common Stock expiring 8/9/18 (acquired 8/9/13)	(M)		148,409	171,183	
Warrants for Common Stock expiring 10/21/18 (acquired 10/21/11)	(M)		18,816	84,846	
			5,116,352		
Cambrios Technologies Corporation (5)(8)(9)(11)					
Developed nanowire-enabled electronic materials for the display industry					
		Electronics			
Series B Convertible Preferred Stock (acquired 11/9/04-2/16/05)	(M)		1,294,025	1,294,025	
Series C Convertible Preferred Stock (acquired 3/21/07)	(M)		1,300,000	1,300,000	
Series D Convertible Preferred Stock (acquired 8/7/09)	(M)		515,756	515,756	
Series D-2 Convertible Preferred Stock (acquired 5/31/11)	(M)		92,400	92,400	
Series D-4 Convertible Preferred Stock (acquired 7/12/12)	(M)		216,168	216,168	
			3,418,349		
Magic Leap, Inc. (8)(9)(12)					
Developing novel human computing interfaces and software					
		Electronics			
Series B Convertible Preferred Stock (acquired 5/1/15)	(I)		338,604	29,291	
Mersana Therapeutics, Inc. (5)(8)(9)					
Developing antibody drug conjugates for cancer therapy					
		Life Sciences			

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

Series A-1 Convertible Preferred Stock (acquired 7/27/12-4/2/14)	(H)	683,538	635,081
Series B-1 Convertible Preferred Stock (acquired 2/20/15)	(H)	104,521	97,111
Common Stock (acquired 7/27/12)	(H)	3,875,395	350,539
		4,663,454	

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, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal
Investments in Unaffiliated Companies (3) – 11.0% of net assets at value (Cont.)				
Private Placement Portfolio (Illiquid) (4) – 6.1% of net assets at value (Cont.)				
Nanosys, Inc. (5)(8)(9) Developing inorganic nanowires and quantum dots for use in LED-backlit devices		Energy		
Series C Convertible Preferred Stock (acquired 4/10/03)	(M)		\$ 1,500,000	803,428
Series D Convertible Preferred Stock (acquired 11/7/05)	(M)		3,000,003	1,016,950
Series E Convertible Preferred Stock (acquired 8/13/10)	(M)		496,573	433,688
			4,996,576	
Nano Terra, Inc. (5)(8) Developing surface chemistry and nano- manufacturing solutions		Energy		
Warrants for Common Stock expiring on 2/22/21 (acquired 2/22/11)	(I)		69,168	4,462
Warrants for Series A-3 Preferred Stock expiring on 11/15/22 (acquired 11/15/12)	(I)		35,403	47,508
			104,571	
Phylagen, Inc. (5)(8)(13) Developing technology to improve human health and business productivity		Life Sciences		
Secured Convertible Bridge Note, 5%, (acquired 2/5/15)	(M)		209,041	\$ 200,000
Secured Convertible Bridge Note, 5%, (acquired 6/5/15)	(M)		10,288	\$ 10,000
			219,329	
Total Unaffiliated Private Placement Portfolio (cost: \$18,857,235)				

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, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	V
Rights to Milestone Payments (Illiquid) (6) – 3.8% of net assets at value					
Amgen, Inc. (8)(9) Rights to Milestone Payments from Acquisition of BioVex Group, Inc. (acquired 3/4/11)	( I )	Life Sciences	\$548,998	\$548,998	\$
Laird Technologies, Inc. (8)(9) Rights to Milestone Payments from Merger & Acquisition of Nextreme Thermal Solutions, Inc. (acquired 2/13/13)	( I )	Energy	0	\$0	0
Canon, Inc. (8)(9) Rights to Milestone Payments from Acquisition of Molecular Imprints, Inc. (acquired 4/18/14)	( I )	Electronics	232,865	\$232,865	\$
Total Unaffiliated Rights to Milestone Payments (cost: \$781,863)					\$
Publicly Traded Portfolio (7) – 1.1% of net assets at value					
Champions Oncology, Inc. (5)(9) Developing its TumorGraft™ platform for personalized medicine and drug development Common Stock (acquired 3/24/11-3/11/15) Warrants for Common Stock expiring 1/28/19 (acquired 1/28/13)	( M ) ( I )	Life Sciences	\$1,622,629 400 1,623,029	243,540 5,500	\$ \$
Total Unaffiliated Publicly Traded Portfolio (cost: \$1,623,029)					\$
Total Investments in Unaffiliated Companies (cost: \$21,262,127)					\$

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, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal
Investments in Non-Controlled Affiliated Companies (3) – 67.9% of net assets at value				
Private Placement Portfolio (Illiquid) (14) – 47.2% of net assets at value				
ABSMaterials, Inc. (5)(8)(9)				
Energy				
Developing nano-structured absorbent materials for water remediation and consumer applications				
Series A Convertible Preferred Stock (acquired 2/17/10-10/24/11)	( I )		\$435,000	390,000
Series B Convertible Preferred Stock (acquired 11/8/13-6/25/14)	( I )		1,217,644	1,037,750
			1,652,644	
AgBiome, LLC (5)(8)(9)				
Life Sciences				
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 (acquired 1/30/13)	( I )		2,000,000	2,000,000
Series A-2 Convertible Preferred Stock (acquired 4/9/13-10/15/13)	( I )		521,740	417,392
Series B Convertible Preferred Stock (acquired 8/7/15)	( I )		500,006	160,526
			3,021,746	
D-Wave Systems, Inc. (8)(9)(15)				
Electronics				
Developing high-performance quantum computing systems				
Series 1 Class B Convertible Preferred Stock (acquired 9/30/08)	( H )		1,002,074	1,144,860
Series 1 Class C Convertible Preferred Stock (acquired 9/30/08)	( H )		487,804	450,450
Series 1 Class D Convertible Preferred Stock (acquired 9/30/08)	( H )		748,473	855,131
Series 1 Class E Convertible Preferred Stock (acquired 11/24/10)	( H )		248,049	269,280
Series 1 Class F Convertible Preferred Stock (acquired 11/24/10)	( H )		238,323	258,721
Series 1 Class H Convertible Preferred Stock (acquired 6/27/14)	( H )		909,088	460,866
Series 2 Class D Convertible Preferred Stock (acquired 9/30/08)	( H )		736,019	678,264
Series 2 Class E Convertible Preferred Stock (acquired 6/1/12-3/22/13)	( H )		659,493	513,900
Series 2 Class F Convertible Preferred Stock (acquired 6/1/12-3/22/13)	( H )		633,631	493,747
Warrants for Common Stock expiring 5/12/19 (acquired 5/12/14)	( I )		26,357	20,415
			5,689,311	
EchoPixel, Inc. (5)(8)				
Life Sciences				

Developing virtual reality 3-D visualization software  
for life sciences and health care applications

Series Seed Convertible Preferred Stock (acquired 6/21/13-6/30/14)	( I )	1,250,000	4,194,63
Secured Convertible Bridge Note, 8%, (acquired 11/25/15)	(M)	113,425	\$ 112,500
		1,363,425	

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, 2015

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Val
Investments in Non-Controlled Affiliated Companies (3) – 67.9% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (14) – 47.2% of net assets at value (Cont.)					
Ensemble Therapeutics Corporation (5)(8)(9) Developing DNA-Programmed Chemistry™ for the discovery of new classes of therapeutics					
		Life Sciences			
Series B Convertible Preferred Stock (acquired 6/6/07)	( I )		\$2,000,000	1,449,275	\$66
Series B-1 Convertible Preferred Stock (acquired 4/21/14)	( I )		679,754	492,575	1,
			2,679,754		2,
HZO, Inc. (5)(8)(9) Developing novel industrial coatings that protect electronics against damage from liquids					
		Electronics			
Common Stock (acquired 6/23/14)	( I )		666,667	405,729	32
Series I Convertible Preferred Stock (acquired 6/23/14)	( I )		5,709,835	2,266,894	4,
Series II Convertible Preferred Stock (acquired 6/23/14-8/3/15)	( I )		2,500,006	674,638	2,
			8,876,508		7,
Laser Light Engines, Inc. (8)(9) Manufactured solid-state light sources for digital cinema and large-venue projection displays					
		Energy			
Series A Convertible Preferred Stock (acquired 5/6/08)	(M)		2,000,000	7,499,062	0
Series B Convertible Preferred Stock (acquired 9/17/10)	(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

Lodo Therapeutics Corporation (5)(8)(9)(13)		Life Sciences			
Developing and commercializing novel therapeutics derived from a metagenome-based Natural Product Discovery Platform					
Series A Convertible Preferred Stock (acquired 12/21/15)	( I )		107,900	107,900	10

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, 2015

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal
Investments in Non-Controlled Affiliated Companies (3) – 67.9% of net assets at value (Cont.)				
Private Placement Portfolio (Illiquid) (14) – 47.2% of net assets at value (Cont.)				
Metabolon, Inc. (5)(8)(9) Developing a biochemical profiling platform for precision medicine		Life Sciences		
Series B Convertible Preferred Stock (acquired 6/29/09)	(M)		\$2,500,000	371,739
Series B-1 Convertible Preferred Stock (acquired 6/29/09)	(M)		706,214	148,696
Series C Convertible Preferred Stock (acquired 4/30/09)	(M)		1,000,000	1,000,000
Series D Convertible Preferred Stock (acquired 8/25/11)	(M)		1,499,999	835,882
Series E-1 Convertible Preferred Stock (acquired 3/2/15)	(M)		1,225,000	444,404
Series E-2 Convertible Preferred Stock (acquired 3/2/15)	(M)		299,999	103,277
			7,231,212	
ORIG3N, Inc. (5)(8)(9)(13) Developing precision medicine applications for induced pluripotent stems cells		Life Sciences		
Series 1 Convertible Preferred Stock (acquired 2/5/15-8/5/15)	(I)		500,000	1,195,315
Series A Convertible Preferred Stock (acquired 11/25/15)	(I)		750,000	682,333
			1,250,000	
Petra Pharma Corporation (5)(8)(9)(13) Developing small molecule inhibitors for treatment of cancer and metabolic diseases		Life Sciences		
Series A Convertible Preferred Stock (acquired 12/23/15)	(I)		1,025,050	1,025,050
Produced Water Absorbents, Inc. (5)(8)(16) Providing integrated process separation solutions to the global oil and gas industries, enabling onsite treatment of produced and flowback water		Energy		
Series A Convertible Preferred Stock (acquired 6/21/11)	(M)		1,000,000	1,000,000
Series B Convertible Preferred Stock (acquired 6/20/13-3/31/14)	(M)		1,496,865	5,987,460
Series B-2 Convertible Preferred Stock (acquired 5/12/14)	(M)		1,015,427	4,322,709
Series B-3 Convertible Preferred Stock (acquired 11/14/13)	(M)		978,641	3,914,564
Series C Convertible Preferred Stock (acquired 5/26/14)	(M)		1,000,268	2,667,380
Series D Convertible Preferred Stock (acquired 2/17/15)	(M)		986,066	2,629,510

Subordinated Secured Debt, 12%, maturing on 6/30/16 (acquired 10/7/14)	(M)	990,634	\$ 1,000,000
Subordinated Convertible Bridge Note, 12%, (acquired 6/3/2015)	(M)	267,425	\$ 250,000
Subordinated Convertible Bridge Note, 12%, (acquired 7/15/2015)	(M)	263,973	\$ 250,000
Subordinated Convertible Bridge Note, 12%, (acquired 9/28/2015)	(M)	257,808	\$ 250,000
Subordinated Convertible Bridge Note, 12%, (acquired 10/30/2015)	(M)	255,178	\$ 250,000
Warrants for Series B-2 Preferred Stock expiring upon liquidation event (acquired 5/12/14)	(I)	65,250	300,000
		8,577,535	

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, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	V
Investments in Non-Controlled Affiliated Companies (3) – 67.9% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (14) – 47.2% of net assets at value (Cont.)					
Ultora, Inc. (5)(8)(17)					
Developed energy-storage devices enabled by carbon nanotubes					
Energy					
Series A Convertible Preferred Stock (acquired 12/5/13)	(M)		\$886,830	17,736	\$
Series B Convertible Preferred Stock (acquired 12/5/13)	(M)		236,603	2,347,254	
Secured Convertible Bridge Note, 5%, (acquired 5/7/14)	(M)		86,039	\$86,039	
Secured Convertible Bridge Note, 5%, (acquired 8/20/14)	(M)		17,208	\$17,208	
Secured Convertible Bridge Note, 5%, (acquired 10/14/14)	(M)		10,750	\$10,750	
Secured Convertible Bridge Note, 5%, (acquired 3/30/15)	(M)		7,525	\$7,525	
			1,244,955		
Total Non-Controlled Private Placement Portfolio (cost: \$49,262,921)					
Publicly Traded Portfolio (18) – 20.7% of net assets at value					
Adesto Technologies Corporation (5)(8)(9)(19)					
Developing low-power, high-performance memory devices					
Electronics					
Common Stock (acquired 10/27/15)	(M)		\$11,482,417	1,769,868	\$
Enumeral Biomedical Holdings, Inc. (5)(8)(9)(20)					
Developing therapeutics and diagnostics through functional assaying of single cells					
Life Sciences					
Common Stock (acquired 7/31/14)	(M)		4,993,357	7,966,368	
Warrants for Common Stock expiring 7/30/19 (acquired 7/31/14)	(I)		540,375	1,500,000	
Warrants for Common Stock expiring 2/2/24 (acquired 7/31/14)	(I)		57,567	255,120	
Options to Purchase Common Stock at \$1.00 expiring 7/30/16 (acquired 8/4/14)	(I)		0	80,000	
			5,591,299		

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, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Publicly Traded Portfolio (18) – 20.7% of net assets at value (Cont.)					
OpGen, Inc. (5)(21)		Life Sciences			
Developing tools for genomic sequence assembly and analysis					
Common Stock (acquired 5/5/15)	(M)		\$5,665,708	1,409,796	\$2,600,000
Warrants for Common Stock expiring 5/8/20 (acquired 5/5/15)	(M)		425,579	300,833	10,000
Warrants for Common Stock expiring 2/17/25 (acquired 5/5/15)	(I)		785	31,206	26,000
			6,092,072		2,800,000
Total Non-Controlled Affiliated Publicly Traded Portfolio (cost: \$23,165,788)					\$18,000,000
Total Investments in Non-Controlled Affiliated Companies (cost: \$72,428,709)					\$60,000,000
Investments in Controlled Affiliated Companies (3) – 7.9% of net assets at value					
Private Placement Portfolio (Illiquid) (22) – 7.9% of net assets at value					
Black Silicon Holdings, Inc. (5)(8)(23)		Electronics			
Holding company for interest in a company that develops silicon-based optoelectronic products					
Series A Convertible Preferred Stock (acquired 8/4/15)	(I)		\$750,000	233,499	\$0
Series A-1 Convertible Preferred Stock (acquired 8/4/15)	(I)		890,000	2,966,667	0
Series A-2 Convertible Preferred Stock (acquired 8/4/15)	(I)		2,445,000	4,207,537	0
Series B-1 Convertible Preferred Stock (acquired 8/4/15)	(I)		1,169,561	1,892,836	0
Series C Convertible Preferred Stock (acquired 8/4/15)	(I)		1,171,316	1,674,030	0
Secured Convertible Bridge Note, 8%, (acquired 8/4/15)	(I)		1,321,068	\$1,278,454	31,000
			7,746,945		31,000

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, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Va
Investments in Controlled Affiliated Companies (3) – 7.9% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (22) – 7.9% of net assets at value (Cont.)					
NGX Bio, Inc. (5)(8)(9)(24)		Life Sciences			
Developing translational genomics solutions					
Series Seed Convertible Preferred Stock (acquired 6/6/14)	(I)		\$375,000	500,000	\$4
Series A Convertible Preferred Stock (acquired 8/20/15-9/30/15)	(I)		499,999	329,989	4
Warrants for Series Seed Preferred Stock expiring 6/6/19 (acquired 6/6/15)	(I)		125,000	166,667	1
			999,999		9
ProMuc, Inc. (5)(8)		Life Sciences			
Developing synthetic mucins for the nutritional, food and health care markets					
Common Stock (acquired 12/18/13)	(M)		1	1,000	1
Secured Convertible Bridge Note, 8%, (acquired 12/18/13)	(M)		407,074	\$350,000	4
Secured Convertible Bridge Note, 8%, (acquired 8/13/14)	(M)		111,091	\$100,000	1
Secured Convertible Bridge Note, 8%, (acquired 8/5/15)	(M)		77,449	\$75,000	7
Secured Convertible Bridge Note, 8%, (acquired 12/7/15)	(M)		55,301	\$55,000	5
			650,916		6
Senova Systems, Inc. (5)(8)(9)		Life Sciences			
Developing next-generation sensors to measure pH					
Series B Convertible Preferred Stock (acquired 9/9/11-7/18/12)	(I)		1,218,462	1,350,000	2
Series B-1 Convertible Preferred Stock (acquired 8/1/13-1/15/14)	(I)		1,083,960	2,759,902	6
Series C Convertible Preferred Stock (acquired 10/24/14-4/1/15)	(I)		1,208,287	1,611,049	1
Warrants for Series B Preferred Stock expiring 10/15/17 (acquired 10/15/12)	(I)		131,538	164,423	3
Warrants for Series B Preferred Stock expiring 4/24/18 (acquired 4/24/13)	(I)		20,000	25,000	5
			3,662,247		2
SynGlyco, Inc. (5)(8)		Life Sciences			
Developed synthetic carbohydrates for pharmaceutical applications					

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

Common Stock (acquired 12/13/11)	(I)	\$2,729,817	57,463	0
Series A' Convertible Preferred Stock (acquired 12/13/11-6/7/12)	(I)	4,855,627	4,855,627	1
Secured Convertible Bridge Note, 8%, (acquired 1/23/13)	(I)	438,931	\$350,000	4
Secured Convertible Bridge Note, 8%, (acquired 4/25/13)	(I)	369,170	\$300,000	3
		8,393,545		9

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, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Controlled Affiliated Companies (3) – 7.9% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (22) – 7.9% of net assets at value (Cont.)					
TARA Biosystems, Inc. (5)(8)		Life Sciences			
Developing human tissue models for toxicology and drug discovery applications					
Common Stock (acquired 8/20/14)	(M)		\$20	2,000,000	\$20
Secured Convertible Bridge Note, 8%, (acquired 8/20/14)	(M)		333,516	\$300,000	500,274
Secured Convertible Bridge Note, 8%, (acquired 5/18/15)	(M)		209,995	\$200,000	314,992
Secured Convertible Bridge Note, 8%, acquired 12/1/15	(M)		1,208,153	\$1,200,000	1,208,153
			1,751,684		2,023,439
Total Controlled Private Placement Portfolio (cost: \$23,205,336)					\$7,010,533
Total Investments in Controlled Affiliated Companies (cost: \$23,205,336)					\$7,010,533
Total Private Placement and Publicly Traded Portfolio (cost: \$116,896,172)					\$76,986,900

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

HARRIS & HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2015**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Equity Method Investments (25) – 0.2% of net assets at value					
Private Placement Portfolio (Illiquid) (25) – 0.2% of net assets at value					
Accelerator IV-New York Corporation (8)(9)(26) Identifying and managing emerging biotechnology companies		Life Sciences			
Series A Common Stock (acquired 7/21/14-1/30/15) (E)			\$ 165,936	478,227	\$ 165,936
Total Equity Method Investments (cost: \$165,936)					\$ 165,936
Total Investments (cost: \$117,062,108)					\$ 77,152,904

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

HARRIS & HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2015**

Notes to Consolidated Schedule of Investments

(1) See "Footnote to Consolidated Schedule of Investments" on page 34 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 and computing. We classify "Life Sciences" companies as those that address problems in life sciences-related industries, including precision health and precision medicine, biotechnology, agriculture, advanced materials and chemicals, health care, 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, including control of a majority of the seats on the board of directors, or more than 25 percent of the seats on the board of directors, with no other entity or person in control of more director seats than us. Among our controlled affiliated companies, ProMuc, Inc., was 100 percent owned by us at December 31, 2015.

The aggregate cost for federal income tax purposes of investments in unaffiliated privately held companies is \$18,857,235. The gross unrealized appreciation based on the tax cost for these securities is \$10,390. The gross unrealized depreciation based on the tax cost for these securities is \$13,491,153.

All or a portion of the investments or instruments are pledged as collateral under our Loan Facility with Orix Corporate Capital, Inc.

The aggregate cost for federal income tax purposes of investments in unaffiliated rights to milestone payments is \$781,863. The gross unrealized appreciation based on the tax cost for these securities is \$2,580,188. The gross unrealized depreciation based on the tax cost for these securities is \$0.

(7)



The aggregate cost for federal income tax purposes of investments in unaffiliated publicly traded companies is \$1,623,029. 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 \$665,485.

(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) On July 21, 2015, Bridgelux, Inc., signed a definitive agreement to be acquired by an investment group led by China Electronics Corporation and ChongQing Linkong Development Investment Company. The close of this transaction is subject to customary regulatory approvals.

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

HARRIS & HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2015**

- (11) In February of 2016, Cambrios Technologies Corporation ceased operations and began liquidation of its assets through a general assignment for the benefit of creditors.

We received our shares of Magic Leap, Inc., as part of the consideration paid for one of our portfolio companies (12) in an acquisition during the second quarter of 2015. A total of 4,394 shares of our 29,291 shares of Magic Leap are held in escrow to satisfy indemnity claims through May 1, 2016.

(13) Initial investment was made in 2015.

The aggregate cost for federal income tax purposes of investments in non-controlled affiliated privately held (14) companies is \$49,262,921. The gross unrealized appreciation based on the tax cost for these securities is \$10,504,995. The gross unrealized depreciation based on the tax cost for these securities is \$17,858,654.

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 (15) 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.

(16) Produced Water Absorbents, Inc., also does business as ProSep, Inc.

(17) In March of 2015, Ultora, Inc., ceased operations and began liquidation of its assets through a general assignment for the benefit of creditors.

The aggregate cost for federal income tax purposes of investments in non-controlled affiliated publicly traded (18) companies is \$23,165,788. The gross unrealized appreciation based on the tax cost for these securities is \$2,163,265. The gross unrealized depreciation based on the tax cost for these securities is \$6,957,948.

As of December 31, 2015, the Company's shares of Adesto Technologies Corporation were subject to a lock-up (19) agreement that restricts our ability to trade these securities. A total of 200,000 shares are not qualifying assets 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.

(20) As of December 31, 2015, a portion of the Company's shares and warrants of Enumeral Biomedical Holdings, Inc., were subject to a lock-up agreement that restricts our ability to trade these securities. The lock-up period on our securities of Enumeral Biomedical Holdings expired on January 31, 2016. A portion of our shares were held in escrow as of the end of 2015. This escrow period expired with no claims against the escrowed shares.

(21) The Company's shares of OpGen, Inc., became freely tradeable on November 2, 2015. A total of 300,833 shares and 300,833 warrants are not qualifying assets 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.

(22) The aggregate cost for federal income tax purposes of investments in controlled affiliated companies is \$23,205,336. The gross unrealized appreciation based on the tax cost for these securities is \$271,755. The gross unrealized depreciation based on the tax cost for these securities is \$16,466,557.

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

HARRIS & HARRIS GROUP, INC.

**CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF DECEMBER 31, 2015**

(23) On August 4, 2015, SiOnyx, Inc., reorganized its corporate structure to become a subsidiary of a new company, Black Silicon Holdings, Inc. Our security holdings of SiOnyx converted into securities of Black Silicon Holdings. SiOnyx was then acquired by an undisclosed buyer. Black Silicon Holdings owns a profit interest in the undisclosed buyer.

(24) On August 19, 2015, UberSeq, Inc., changed its name to NGX Bio, Inc.

(25) The aggregate cost for federal income tax purposes of investments in privately held equity method investments is \$165,936. Under the equity method, investments are carried at cost, plus or minus the Company's equity in the increases and decreases in the investee's net assets after the date of acquisition and certain other adjustments.

(26) 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."

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.

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: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include 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.

The Company values one investment using the equity method.

Equity Method (E): Under the equity method, investments are carried at cost, plus or minus the Company's equity in the increases and decreases in the investee's net assets after the date of acquisition and certain other adjustments.

## **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**

**(Unaudited)**

### **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 period ended March 31, 2016, there was no non-passive investment income generated by Harris Partners I, L.P. Ventures, as the sole general partner, consolidates Harris Partners I, L.P. The Company consolidates its wholly owned subsidiary, Ventures, for financial reporting purposes.

### **NOTE 2. INTERIM FINANCIAL STATEMENTS**

Our interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and in conformity with accounting principles generally accepted in the United States of America ("GAAP") applicable to interim financial information. Accordingly, the information presented on our interim financial statements does not include all information and disclosures necessary for a fair statement of our financial position, results of operations and cash flows in conformity with GAAP for annual financial statements. In the opinion of management, these financial statements reflect all adjustments, consisting of valuation adjustments and normal recurring accruals, necessary for a fair statement of our financial position, results of operations and cash flows for such periods. The results of operations for any interim period are not necessarily indicative of the results for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

### **NOTE 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**



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

40

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. Amounts reported in "Net increases in unrealized depreciation on investments" have been reclassified from prior years. Amounts related to portfolio company investments were previously reported as a single amount and have been reclassified to present unrealized (depreciation) appreciation from unaffiliated companies, controlled affiliated companies, unaffiliated rights to milestone payments, non-controlled affiliated companies, publicly traded companies and other investments. There was no impact to the total amounts reported in any period.

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 March 31, 2016, our financial statements include investments fair valued by the Board of Directors at \$60,084,507 and one investment valued under the equity method at \$228,133. The fair values and equity method value were determined in good faith by, or under the direction of, the Board of Directors. The fair value amount includes the values of our privately held investments as well as the securities of Champions Oncology, Inc., certain warrants and options of Enumeral Biomedical Holdings, Inc., and the warrants of OpGen, Inc., which are publicly traded companies. Our investment in Accelerator-New York IV is accounted for under the equity method of accounting as it represents a non-controlling interest in an operating entity that provides investment advisory services to the Company. Under the equity method, investments are carried at cost, plus or minus the Company's equity in the increases and decreases in the investee's net assets after the date of acquisition and certain other adjustments. The Company's share of the net income or loss of the investee is included in "Equity in earnings/(loss) from equity method investees" on the Company's "Consolidated Statements of Operations." Upon sale of investments, the values that are ultimately realized may be different from the fair value presented in the Company's financial statements. The difference could be material.

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



Unaffiliated Rights to Milestone Payments. At March 31, 2016, and December 31, 2015, the outstanding potential milestone payments from Amgen, Inc.'s acquisition of BioVex Group, Inc., were valued at \$2,495,696 and \$2,900,232, 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. On November 23, 2015, the Company received a payment of \$2,070,955 owing to the achievement of the second milestone. If all the remaining milestones are met, we would receive \$4,141,910. At March 31, 2016, and December 31, 2015, the outstanding potential milestone payments from Canon, Inc.'s acquisition of Molecular Imprints, Inc., were valued at \$464,073 and \$461,819, respectively. On October 1, 2015, the Company received a payment of \$795,567 owing to the achievement of the first milestone. If all the remaining milestones are met, we would receive an additional \$938,926. At March 31, 2016, and December 31, 2015, 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 assurances as to how much of these amounts we will ultimately realize or when they will be realized, if at all.

Funds Held in Escrow from Sale of Investment. At March 31, 2016, and December 31, 2015, there were funds held in escrow fair valued at \$506,949 and \$311,137, respectively, relating to the sale of Molecular Imprints, Inc.'s semiconductor lithography equipment business to Canon, Inc. On April 20, 2016, the Company received proceeds of \$390,492 from the release of a portion of the funds held in escrow following the transaction. The remaining funds held in escrow are expected to be released in April of 2017, net of 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 \$118,051. At March 31, 2016, and December 31, 2015, there were funds held in escrow fair valued at \$126,972 and \$63,428, respectively, relating to the sale of Molecular Imprints' non-semiconductor business to Magic Leap, Inc., that are expected to be released in May of 2016, net of 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 \$126,972.

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 5. Debt." Amortization of the financing charges is included in "Interest and other debt expense" in the Consolidated Statements of Operations.

Property and Equipment. Property and equipment are included in "Other assets" and are carried at \$168,634 and \$180,089 at March 31, 2016, and December 31, 2015, respectively, representing cost, less accumulated depreciation of \$454,587 and \$445,476, 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 post-retirement benefit cost for the year includes service cost for the year and interest on the accumulated post-retirement 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 three months ended March 31, 2016, and March 31, 2015, the Company earned \$34,865 and \$82,807, respectively, in interest on subordinated secured debt, non-convertible promissory notes, senior secured debt and interest-bearing accounts. During the three months ended March 31, 2016, and March 31, 2015, the Company recorded, on a net basis, \$115,675 and \$53,025, respectively, of bridge note interest.

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. For the three months ended March 31, 2016, and March 31, 2015, total yield-enhancing fees accreted into investment income were \$4,625, and \$26,307, respectively.

Fees for Providing Managerial Assistance to Portfolio Companies. For the three months ended March 31, 2016, and March 31, 2015, the Company earned income of \$146,877 and \$7,000, respectively, owing to certain of its employees providing managerial assistance to certain portfolio companies.

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. Previously recorded unrealized gains and losses on expired, exercised or closed options are reversed at the time of such transactions. At March 31, 2016, and December 31, 2015, the Company did not have shares covered by call option contracts.



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. For the three months ended March 31, 2016, and March 31, 2015, 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 9. 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. 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. 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 leased office space in California until December 31, 2015, and in North Carolina until December 31, 2014.

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 currently intend to continue to qualify as a RIC under Subchapter M of the Code and distribute any ordinary income, 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). Securities transactions outside conventional channels, such as private transactions, are recorded as of the date the Company obtains the right to demand the securities purchased or to collect the proceeds from a sale and incurs the obligation to pay for the securities purchased or to deliver the securities sold.

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's insured limit and is subject to the credit risk of such institutions to the extent it exceeds such limit.

Concentration of Investor Risk. As of March 31, 2016, three investors, Ariel Investments, Granahan Investment Management and Susan T. Harris owned approximately 11.4 percent, 6.3 percent and 5.4 percent of our outstanding shares, respectively.

Recent Accounting Pronouncements. On April 7, 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-03, "*Simplifying the Presentation of Debt Issuance Costs*" ("ASU 2015-03"), which requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of related debt liability, consistent with debt discounts. Under the former accounting standards, such costs were recorded as an asset. On August 18, 2015, the FASB clarified that the guidance in ASU 2015-03 does not apply to line of credit arrangements. Accordingly, companies may continue to present debt issuance costs for line of credit arrangements as an asset and subsequently amortize the deferred debt costs ratably over the term of the arrangement. The new guidance in ASU 2015-03 was adopted on January 1, 2016, and did not have a material impact on the Company's Consolidated Financial Statements.

On February 18, 2015, the FASB issued ASU 2015-02, "*Consolidation (Topic 810): Amendments to the Consolidation Analysis*" that amends the current consolidation guidance. The amendments affect both the variable interest entity and voting interest entity consolidation models. The new guidance was adopted on January 1, 2016, and did not have a material impact on the Company's Consolidated Financial Statements.

On May 28, 2014, the FASB and the International Accounting Standards Board ("IASB") issued their final converged standard on revenue recognition. The standard, issued as ASU 2014-09, "*Revenue from Contracts with Customers*" by the FASB, provides a single, comprehensive revenue recognition model for all contracts with customers and supersedes current revenue recognition guidance. The revenue standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The new standard also includes enhanced disclosures which are significantly more comprehensive than those in existing revenue standards. ASU 2014-09 was to be effective for the

Company beginning January 1, 2017. However, on July 9, 2015, the FASB voted to approve a one-year deferral of the effective date. This new guidance is now expected to be effective for the Company beginning January 1, 2018. The standard allows for either "full retrospective" adoption, meaning the standard is applied to all of the periods presented, or "modified retrospective" adoption, meaning the standard is applied only to the most current period presented in the financial statements. The impact on the Company's Consolidated Financial Statements is currently being evaluated.

On June 19, 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 was adopted on January 1, 2016, and did not have a material impact on the Company's Consolidated Financial Statements.

On August 27, 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 impact on the Company's Consolidated Financial Statements is currently being evaluated.

On February 25, 2016, the FASB issued ASU No. 2016-02, "*Leases (Topic 842).*" This ASU revises the accounting for leases. Under the new guidance, lessees are required to recognize a right-of-use asset and a lease liability for all leases. The new guidance will continue to classify leases as either financing or operating, with classification affecting the pattern of expense recognition. The accounting applied by a lessor under the new guidance will be substantially equivalent to current lease accounting guidance. The new guidance is effective January 1, 2019, with early adoption permitted. The new standard is required to be applied with a modified retrospective approach to each prior reporting period presented and provides for certain practical expedients. The impact on the Company's Consolidated Financial Statements is currently being evaluated.

On March 30, 2016, the FASB issued ASU No. 2016-09, "*Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.*" This ASU is intended to simplify several aspects of the accounting for share-based payment award transactions. The guidance will be effective for the fiscal year beginning after December 15, 2016, including interim periods within that year. The impact on the Company's Consolidated Financial Statements is currently being evaluated.

#### **NOTE 4. BUSINESS RISKS AND UNCERTAINTIES**

We invest primarily in privately held companies, the securities of which are inherently illiquid. We also have investments in small publicly traded companies. Although these companies are publicly traded, their stock may not trade at high volumes, which may restrict our ability to sell our positions and prices can be volatile. 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 March 31, 2016, and December 31, 2015, our largest 10 investments by value accounted for approximately 79 percent and 79 percent, respectively, of the value of our equity-focused portfolio. Our largest three investments, by value, D-Wave Systems, Inc., Metabolon, Inc., and Adesto Technologies Corporation accounted for approximately 16 percent, 16 percent and 14 percent, respectively, of our equity-focused portfolio at March 31, 2016. Our largest three investments, by value, Adesto Technologies Corporation, Metabolon, Inc., and HZO, Inc., accounted for approximately 19 percent, 18 percent and 10 percent, respectively, of our equity-focused portfolio at December 31, 2015. D-Wave Systems, Metabolon and HZO are privately held portfolio companies. Adesto Technologies is a publicly traded portfolio company.

Approximately 81 percent of the portion of our equity-focused portfolio that was fair valued was comprised of securities of 24 privately held companies, the securities of publicly traded Champions Oncology, Inc., the warrants of OpGen, Inc., and certain warrants and options of Enumeral Biomedical Holdings, Inc. Approximately 0.3 percent of the portion of our equity-focused portfolio that was valued according to the equity method was comprised of one privately held company. 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 5. DEBT**

The Company has a \$20 million Loan Facility with Orix Corporate Capital, Inc., which may be used to fund investments in portfolio companies. 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 pays interest in cash on its outstanding borrowings. 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 March 31, 2016, and December 31, 2015, the Company had outstanding debt of \$5,000,000. The weighted average annualized interest rate for each of the three months ended March 31, 2016, and the year ended December 31, 2015, was 10 percent, exclusive of amortization of closing fees and other expenses. The weighted average debt outstanding for the three months ended March 31, 2016, and the year ended December 31, 2015, was \$5,000,000. The remaining capacity under the Loan Facility was \$15,000,000 at March 31, 2016. Unamortized fees and expenses of \$262,320 and \$306,040 related to establishing the Loan Facility are included as "Prepaid expenses" in the Consolidated Statements of Assets and Liabilities as of March 31, 2016, and December 31, 2015, respectively. These amounts are amortized over the term of the Loan Facility, and \$43,720 was amortized in each of the three months ended March 31, 2016, and March 31, 2015. The Company paid \$37,917 and \$50,000 in non-utilization fees during the three months ended March 31, 2016, and March 31, 2015, respectively. The Company paid \$126,389 and \$0 in interest expense for the three months ended March 31, 2016, and March 31, 2015, respectively. During the three months ended March 31, 2016, and March 31, 2015, the Company paid \$0 and \$50,000 in utilization fees associated with a drawdown of the Loan Facility. At March 31, 2016, the Company was in compliance with all covenants required by the Loan Facility.

#### **NOTE 6. FAIR VALUE OF INVESTMENTS**

At March 31, 2016, our financial assets valued at fair value were categorized as follows in the fair value hierarchy:

Description	Fair Value Measurement at Reporting Date Using:			
	March 31, 2016	Unadjusted Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Privately Held Portfolio Companies:				
Preferred Stock	\$49,625,042	\$ 0	\$ 0	\$ 49,625,042
Bridge Notes	4,203,806	0	0	4,203,806
Warrants	249,135	0	0	249,135
Rights to Milestone Payments	2,959,769	0	0	2,959,769
Common Stock	668,032	0	0	668,032
Subordinated Secured Debt	570,491	0	0	570,491
Senior Secured Debt	875,000	0	0	875,000
Options	0	0	0	0

Publicly Traded Portfolio  
Companies:



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

Common Stock	\$14,142,321	\$ 13,209,089	\$ 933,232	\$ 0
Total Investments:	\$73,293,596	\$ 13,209,089	\$ 933,232	\$ 59,151,275
Funds Held in Escrow From Sales of Investments:	\$633,921	\$ 0	\$ 0	\$ 633,921
Total Financial Assets:	\$73,927,517	\$ 13,209,089	\$ 933,232	\$ 59,785,196

**Financial Instruments Disclosed, but not Carried, at Fair Value**

The following table presents the carrying value and the fair value of the Company's financial liabilities disclosed, but not carried, at fair value as of March 31, 2016, and the level of each financial liability within the fair value hierarchy:

Description	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Term Loan Credit Facility <sup>(1)</sup>	\$ 5,000,000	\$5,000,000	\$ 0	\$ 0	\$5,000,000
Total	\$ 5,000,000	\$5,000,000	\$ 0	\$ 0	\$5,000,000

(1) Fair value of the Term Loan Credit Facility is equal to the carrying amount of this credit facility.

**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 March 31, 2016	Valuation Technique(s)	Unobservable Input	Range (Weighted Average <sup>(a)</sup> )
Preferred Stock	\$ 12,257,859	Hybrid Approach	Private Offering Price Volatility Time to Exit	\$1.08 - \$2.62 (\$2.53) 54.2% - 135.7% (59.0%) 1.0 - 1.5 Years (1.47)
Preferred Stock	22,606,559	Income Approach	Private Offering Price Non-Performance Risk Volatility Time to Exit	\$0.34 - \$3.71 (\$2.18) 0% - 40% (1.8%) 0% - 135.7% (69.2%) 1.0 - 4.8 Years (2.8)
Preferred Stock	14,760,624	Market Approach	Private Offering Price Non-Performance Risk Volatility Revenue Multiples Time to Exit	\$21.31 (\$21.31) 0% - 25% (3.08%) 0% - 62.1% (50.5%) 0 - 4.40 (3.59) 0.2 - 2 Years (1.1)

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

Discount for Lack of Marketability 0% - 17.3% (14.2%)

Bridge Notes	645,741	Income Approach	Private Offering Price	\$1.00 (\$1.00)
Bridge Notes	3,558,065	Market Approach	Private Offering Price	\$0.57 - \$1.00 (\$0.99)

Cont'd

	Fair Value at March 31, 2016	Valuation Technique(s)	Unobservable Input	Range (Weighted Average <sup>(a)</sup> )
Common Stock	308,007	Hybrid Approach	Private Offering Price Volatility Time to Exit	\$1.08 (\$1.08) 135.7% (135.7%) 1 Year (1)
Common Stock	359,994	Income Approach	Private Offering Price Volatility Time to Exit	\$3.71 (\$3.71) 53.2% (53.2%) 3 Years (3)
Common Stock	31	Market Approach	Private Offering Price	\$0.00001 - \$0.0010 (\$0.0001)
Warrants	107,141	Income Approach	Stock Price Volatility Expected Term	\$0.0071 - \$3.83 (\$0.88) 0% - 94.7% (72.9%) 1.50 - 8.89 Years (5.66)
Warrants	141,994	Market Approach	Stock Price Volatility Expected Term	\$0.24 - \$2.58 (\$1.37) 0% - 61.9% (29.9%) 0.17 - 6.63 Years (3.19)
Rights to Milestone Payments	2,959,769	Probability Weighted Discounted Cash Flow	Probability of Achieving Independent Milestones Probability of Achieving Dependent Milestones	0% - 100% (54%) 0% - 75% (28%)
Subordinated Secured Debt	570,491	Market Approach	Market Price	0.57 (0.57)
Senior Secured Debt	875,000	Market Approach	Effective Yield	0% (0%)
Funds Held in Escrow From Sales of Investments	633,921	Market Approach	Escrow Discount	0% - 50% (9%)
Options	0	Income Approach	Stock Price Volatility Expected Term	\$0.16 (\$0.16) 84% (84%) 0.33 Years (0.33)
Total	\$ 59,785,196			

(a) Weighted average based on fair value at March 31, 2016.

50

### 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.

#### *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 also include discount factors for adjustments to transaction/sale values and discount ratios for discounted cash flows in our definition of non-performance risk. 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. We may also consider changes in market values for sets of comparable companies when recent private transaction information is not available.

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. Conversely, we may acquire or hold notes that are pari passu with other notes but have different conversion terms. In such cases, we may apply an adjustment factor to reflect the differences in the terms with respect to values.

### ***Warrants and Options***

We use the Black-Scholes-Merton option-pricing model to determine the fair value of warrants and options held in our portfolio unless there is a publicly traded active market for such warrants and options or another indication of value such as a sale of the portfolio company. 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.





***Subordinated Secured Debt and Senior Secured Debt***

We invest in venture debt investments through subordinated secured debt and senior secured debt. We value these securities using an income approach. The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present value amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Common inputs for valuing Level 3 debt investments include: the effective yield of the debt investment or, in the case where we have received warrant coverage, the warrant-adjusted effective yield of the security, adjustments for changes in the yields of comparable publicly traded high-yield debt funds and risk-free interest rates and an assessment of non-performance risk. For 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.

The following chart shows the components of change in the financial assets categorized as Level 3 for the three months ended March 31, 2016.

	<b>Beginning Balance 1/1/2016</b>	<b>Total Realized (Losses) Gains Included in Changes in Net Assets</b>	<b>Transfers</b>	<b>Total Unrealized Appreciation Included in Changes in Net Assets</b>	<b>Investments in Portfolio Companies, Interest on Bridge Notes and Amortization of Loan Fees, Net</b>	<b>Disposals and Settlements</b>	<b>Ending Balance 3/31/2016</b>	<b>Amount of (Depreciation) Appreciation the Period Included in Changes in Assets Attributable to the Change in Unrealized or Gains Related to Assets Still at the Reporting Date</b>
Preferred Stock	\$48,568,205	\$(4,541,782) <sup>1</sup>	\$148,958 <sup>2</sup>	\$4,949,659	\$500,002	\$0	\$49,625,042	\$407,877
Bridge Notes	4,275,728	(121,522) <sup>1</sup>	0	22,876	890,674	(863,950)	4,203,806	(98,647)
Common Stock	639,786	0	0	28,236	10	0	668,032	28,236

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

Warrants	480,025	0	(148,958) <sup>2</sup>	(81,932 )	0	0	249,135	(81,932 )
Rights to Milestone Payments	3,362,051	0	0	(402,282 )	0	0	2,959,769	(402,282)
Subordinated Secured Debt	560,538	0	0	5,328	4,625	0	570,491	5,328
Senior Secured Debt	0	0	0	0	875,000	0	875,000	0
Funds Held in Escrow From Sales of Investments	374,565	259,356 <sup>3</sup>	0	0	0	0	633,921	0
Options	54	0	0	(54 )	0	0	0	(54 )
OTC Traded Common Stock	29,732	0	(29,732 )	0	0	0	0	0
Total	\$58,290,684	\$(4,403,948)	\$(29,732 )	\$4,521,831	\$2,270,311	\$(863,950)	\$59,785,196	\$(141,474)

<sup>1</sup> Represents a gross realized loss.

<sup>2</sup> There was a \$148,958 transfer from "Warrants" into "Preferred Stock" owing to the exercise of an NGX Bio, Inc., warrant.

<sup>3</sup> Represents a gross realized gain.

For the three months ended March 31, 2016, there were transfers out of Level 3 investments totaling \$29,732. A total of 129,327 of our shares of Enumeral Biomedical Holdings, Inc., transferred from Level 3 investments to Level 1 investments owing to the use of their unadjusted closing share price on their respective stock exchanges on March 31, 2016, to derive their value.

At December 31, 2015, our financial assets valued at fair value were categorized as follows in the fair value hierarchy:

Fair Value Measurement at Reporting Date Using:

Description	December 31, 2015	Unadjusted Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Privately Held Portfolio Companies:				
Preferred Stock	\$48,568,205	\$ 0	\$ 0	\$ 48,568,205
Bridge Notes	4,275,728	0	0	4,275,728
Warrants	480,025	0	0	480,025
Rights to Milestone Payments	3,362,051	0	0	3,362,051
Common Stock	639,786	0	0	639,786
Subordinated Secured Debt	560,538	0	0	560,538
Options	54	0	0	54
Publicly Traded Portfolio Companies:				
Common Stock	\$ 19,100,581	\$ 18,126,030	\$ 944,819	\$ 29,732
Total Investments:	\$76,986,968	\$ 18,126,030	\$ 944,819	\$ 57,916,119
Funds Held in Escrow From Sales of Investments:	\$374,565	\$ 0	\$ 0	\$ 374,565
Total Financial Assets:	\$77,361,533	\$ 18,126,030	\$ 944,819	\$ 58,290,684

*Financial Instruments Disclosed, but not Carried, at Fair Value*

The following table presents the carrying value and the fair value of the Company's financial liabilities disclosed, but not carried, at fair value as of December 31, 2015, and the level of each financial liability within the fair value hierarchy:

Description	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Term Loan Credit Facility <sup>(1)</sup>	\$ 5,000,000	\$5,000,000	\$ 0	\$ 0	\$5,000,000
Total	\$ 5,000,000	\$5,000,000	\$ 0	\$ 0	\$5,000,000

(1) Fair value of the Term Loan Credit Facility is equal to the carrying amount of this credit facility.

**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, 2015	Valuation Technique(s)	Unobservable Input	Range (Weighted Average <sup>(a)</sup> )
Preferred Stock	\$ 7,648,727	Hybrid Approach	Private Offering Price Volatility Time to Exit	\$1.08 - \$2.17 (\$2.07) 48.8% - 131.2% (56.5%) 1.25 - 1.5 Years (1.48)
Preferred Stock	22,784,347	Income Approach	Private Offering Price Non-Performance Risk Volatility Time to Exit	\$0.02 - \$23.03 (\$2.65) 0% - 48% (4.4%) 0% - 112.8% (68.4%) 1.0 - 5.0 Years (2.8)
Preferred Stock	18,135,131	Market Approach	Volatility Revenue Multiples Time to Exit Discount for Lack of Marketability	0% - 54.1% (45.5%) 0 - 5.9 (4.76) 0.2 - 2 Years (1.2) 0% - 16.7% (12.9%)
Bridge Notes	1,124,714	Income Approach	Private Offering Price	\$1.00 (\$1.00)
Bridge Notes	3,151,014	Market Approach	Private Offering Price	\$0.56 - \$1.00 (\$0.98)
Common Stock	309,963	Hybrid Approach	Private Offering Price Volatility Time to Exit	\$1.08 (\$1.08) 131.2% (131.2%) 1.25 Years (1.25)
Common Stock	329,802	Income Approach	Private Offering Price Volatility Time to Exit	\$0 - \$3.71 (\$3.71) 50.8% (50.8%) 3 Years (3)
Common Stock	21	Market Approach	Private Offering Price	\$0.0001 - \$0.001 (\$0.0001)

Cont'd

	Fair Value at December 31, 2015	Valuation Technique(s)	Unobservable Input	Range (Weighted Average <sup>(a)</sup> )
Warrants	101,431	Market Approach	Volume Weighted Average Price	0.34 (0.34)
Warrants	378,594	Income Approach	Stock Price Volatility Expected Term	\$0.21 - \$3.88 (\$1.04) 48.8% - 101.9% (64%) 0.03 - 9.14 Years (3.34)
Rights to Milestone Payments	3,362,051	Probability Weighted Discounted Cash Flow	Probability of Achieving Independent Milestones Probability of Achieving Dependent Milestones	25% - 100% (58%) 0% - 75% (36%)
Subordinated Secured Debt	560,538	Market Approach	Market Price	0.56 (0.56)
Funds Held in Escrow From Sales of Investments	374,565	Market Approach	Escrow Discount	50% (50%)
Options	54	Income Approach	Stock Price Volatility Expected Term	\$0.23 (\$0.23) 79% (79%) 0.58 Years (0.58)
OTC Traded Common Stock	29,732	Market Approach	Stock Price	\$0.23 (\$0.23)
Total	\$ 58,290,684			

<sup>(a)</sup> Weighted average based on fair value at December 31, 2015.

The following chart shows the components of change in the financial assets categorized as Level 3 for the three months ended March 31, 2015.

	<b>Beginning Balance 1/1/2015</b>	<b>Total Realized (Losses) Gains Included in Transfers Changes in Net Assets</b>		<b>Total Unrealized Appreciation (Depreciation) Included in Changes in Net Assets</b>	<b>Investments in Portfolio Companies, Interest on Bridge Notes, and Amortization of Loan Fees, Net</b>	<b>Disposals and Settlements</b>	<b>Ending Balance 3/31/2015</b>	<b>Amount of Total (Depreciation) Appreciation for the Period Included in Changes in Net Assets Attributed to the Change in Unrealized Gain or Losses Relating to Assets Still Held at the Reporting Date</b>
Preferred Stock	\$70,969,603	\$0	\$501,863 <sup>1</sup>	\$(2,051,657)	\$1,334,026	\$0	\$70,753,835	\$(2,051,657)
Bridge Notes	2,163,916	0	(501,863) <sup>1</sup>	1,506,404	1,072,086	0	4,240,543	1,506,404
Common Stock	535,280	0	(51,627 )	115,034	0	0	598,687	115,034
Warrants	2,026,864	(284,844)	0	(429,144 )	0	(24,000 )	1,288,876	(230,524 )
Rights to Milestone Payments	3,193,865	0	0	916	0	0	3,194,781	916
Senior Secured Debt	1,203,299	0	0	(31,875 )	16,118	(91,736 )	1,095,806	(31,875 )
Subordinated Secured Debt	979,450	0	0	(8,539 )	10,189	0	981,100	(8,539 )
Funds Held in Escrow From	306,802	1,543	0	0	0	0	308,345	0



Sales of  
Investments

Options	50,690	0	0	(1,410 )	0	0	49,280	(1,410 )
OTC Traded								
Common Stock	7,251,178	0	0	(1,532,943)	0	0	5,718,235	(1,532,943)
Total	\$88,680,947	\$(283,301)	\$(51,627 )	\$(2,433,214)	\$2,432,419	\$(115,736)	\$88,229,488	\$(2,234,594)

<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 three months ended March 31, 2015, there were transfers out of Level 3 totaling \$51,627. Our shares of Accelerator IV-New York Corporation transferred from a Level 3 investment owing to its qualification as an equity method investment.

**NOTE 7. DERIVATIVES**

At March 31, 2016, and December 31, 2015, 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 \$2,495,696 and \$2,900,232 as of March 31, 2016, and December 31, 2015, respectively. At March 31, 2016, and December 31, 2015, 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 March 31, 2016, and December 31, 2015. At March 31, 2016, and December 31, 2015, 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 \$464,073 and \$461,819 as of March 31, 2016, and December 31, 2015, respectively. These milestone payments are contingent upon certain milestones being achieved in the future.

The following tables present the value of derivatives held at March 31, 2016, and the effect of derivatives held during the three months ended March 31, 2016, along with the respective location in the financial statements.

**Statements of Assets and Liabilities:**

Derivatives	Assets		Liabilities	
	Location	Fair Value	Location	Fair Value
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Investments	\$2,495,696	—	—
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	\$464,073	—	—

**Statements of Operations**

**for the Year Ended**

**March 31, 2016:**

Derivatives	Location	Realized	Change in Unrealized
		Gain/(Loss)	Appreciation
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Net Realized and Unrealized Gain (Loss)	\$ 0	\$ (404,536 )
Laird Technologies, Inc. Rights to Milestone Payments from Acquisition of	Net Realized and Unrealized Gain (Loss)	\$ 0	\$ 0

Nextreme Thermal Solutions,  
Inc.

Canon, Inc. Rights to  
Milestone Payments from  
Acquisition of Molecular  
Imprints, Inc.

Net Realized and Unrealized Gain (Loss)	\$	0	\$	2,254
---	----	---	----	-------

The following tables present the value of derivatives held at December 31, 2015, and the effect of derivatives held during the year ended December 31, 2015, along with the respective location in the financial statements.

**Statements of Assets and Liabilities:**

Derivatives	Assets		Liabilities	
	Location	Fair Value	Location	Fair Value
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Investments	\$2,900,232	—	—
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	\$461,819	—	—

**Statements of Operations**

**for the Year Ended**

**December 31, 2015:**

Derivatives	Location	Realized	Change in
		Gain/(Loss)	Unrealized Appreciation
Amgen, Inc. Rights to Milestone Payments from Acquisition of BioVex Group, Inc.	Net Realized and Unrealized Gain (Loss)	\$ 862,346	\$ 1,543,924
	Net Realized and Unrealized Gain (Loss)	\$ 0	\$ 0

Laird Technologies, Inc.  
 Rights to Milestone Payments  
 from Acquisition of  
 Nextreme Thermal Solutions,  
 Inc.

Canon, Inc. Rights to Milestone Payments from Acquisition of Molecular Imprints, Inc.	Net Realized and Unrealized Gain (Loss)	\$ 398,762	\$ 229,676
--	---	------------	------------

**NOTE 8. EMPLOYEE BENEFITS**

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 each of the three months ended March 31, 2016, and March 31, 2015, a total of \$52,246 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.

**NOTE 9. 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").

***Stock Option Awards***

During the three months ended March 31, 2016, and the year ended December 31, 2015, the Compensation Committee of the Board of Directors of the Company did not grant any stock options. The Compensation Committee does not plan to grant new stock options to employees.

The stock options outstanding are fully vested and, therefore, fully expensed.

No options were exercised during the three months ended March 31, 2016, and March 31, 2015. Upon exercise, shares would be issued from our previously authorized but unissued shares.

A summary of the changes in outstanding stock options for the three months ended March 31, 2016, is as follows:

	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Shares				

Options Outstanding at January 1, 2016	1,402,912	\$ 9.85	\$ 6.34	0.70	\$ 0
Granted	0	0	0	0	
Exercised	0	0	0	0	
Forfeited or Expired	0	0	0	0	
Options Outstanding and Exercisable at March 31, 2016	1,402,912	\$ 9.85	\$ 6.34	0.45	\$ 0

60

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 \$1.65 on March 31, 2016, 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 March 31, 2016.

### ***Restricted Stock***

For the three months ended March 31, 2016, and March 31, 2015, we recognized \$(104,566) and \$212,591 of compensation expense related to restricted stock awards. Our compensation (benefit) expense of \$(104,566) for the three months ended March 31, 2016, includes \$166,226 of compensation expense, net of a reversal of previously recognized compensation expense of \$270,792 owing to pre-vested forfeitures. As of March 31, 2016, there was unrecognized compensation cost of \$726,307 related to restricted stock awards. This cost is expected to be recognized over a remaining weighted average period of approximately eleven months.

Non-vested restricted stock awards as of March 31, 2016, and changes during the three months ended March 31, 2016, were as follows:

	Shares	Weighted-Average Grant Date Fair Value Per Share
Outstanding at January 1, 2016	1,062,329	\$ 2.66
Granted	0	0
Vested based on service	0	0
Shares withheld related to net share settlement of restricted stock	0	0
Forfeited	(210,000 )	2.65
Outstanding at March 31, 2016	852,329	\$ 2.66

Non-vested restricted stock awards as of March 31, 2015, and changes during the three months ended March 31, 2015, were as follows:

Shares



**Weighted-Average Grant Date  
Fair Value Per Share**

Outstanding at January 1, 2015	1,165,495	\$	2.73
Granted	0		0
Vested based on service	0		0
Shares withheld related to net share settlement of restricted stock	0		0
Forfeited	(3,999 )		3.44
Outstanding at March 31, 2015	1,161,496	\$	2.73

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. There were no net settlements during the three months ended March 31, 2016, and March 31, 2015.

#### **NOTE 10. INCOME TAXES**

We have elected to be treated as a RIC under the Code and operate in a manner so as to qualify for the tax treatment applicable to RICs.

In order to qualify as a RIC, we must, in general, (1) annually, derive at least 90 percent of our gross income from dividends, interest, gains from the sale of securities and similar sources; (2) quarterly, meet certain investment diversification requirements; and (3) annually, distribute at least 90 percent of our investment company taxable income as a dividend. We may either distribute or retain our net capital gain from investments to the extent they are not offset by capital loss carryforwards, but any net capital gain not distributed will be subject to corporate income tax and the excise tax described below to the extent not offset by the capital loss carryforward. We currently intend to consider designating net capital gains for distribution as "cash dividends," "designated undistributed capital gains" or "deemed dividends" or some combination thereof. We will be subject to a four percent excise tax to the extent we fail to distribute at least 98 percent of our annual net ordinary income and 98.2 percent of our capital gain net income and would be subject to income tax to the extent we fail to distribute 100 percent of our investment company taxable income. As of January 1, 2016, we had capital loss carryforwards of \$5,252,546, which we intend to use to offset current year capital gains, if any. During the three months ended March 31, 2016, we realized net capital losses of \$4,403,948.

Because of the specialized nature of our investment portfolio, we generally can satisfy the diversification requirements under the Code if we receive a certification from the SEC pursuant to Section 851(e) of the Code that we are "principally engaged in the furnishing of capital to other corporations which are principally engaged in the development or exploitation of inventions, technological improvements, new processes, or products not previously generally available."

Although we received SEC certifications for 1999 to 2014, 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 2015. 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 90 Percent Income Test or Annual Distribution Requirement for such year. In the event we do not satisfy the 90 Percent Income Test, the Diversification Tests and the Annual Distribution

Requirement 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, income from fees and consulting payments generally does not qualify as good RIC income under the 90 Percent Income Test. As we generate more income from such payments, it is possible that we may fail to qualify as a RIC for a taxable year owing to an inability to satisfy the 90 Percent Income Test. We believe this income will be greater in 2016 than in past years, and there can be no assurances that we will satisfy the 90 Percent Income Test in 2016 or qualify as a RIC for such year. Furthermore, 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.

For the three months ended March 31, 2016, and March 31, 2015, we paid \$5,830 and \$105, respectively, in federal, state and local taxes. At March 31, 2016, and March 31, 2015, we had \$0 accrued for federal, state and local taxes payable by the Company.

We pay federal, state and local taxes on behalf of Ventures, which is taxed as a C Corporation. For the three months ended March 31, 2016, and March 31, 2015, our income tax expense for Ventures was \$800 and \$0, respectively.

#### **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, 2015, \$262,215 in capital related to the operating commitment and \$1,132,950 in capital related to the investment commitment was called. During the three months ended March 31, 2016, \$103,680 in capital related to the operating commitment was called. As of March 31, 2016, the Company had remaining unfunded commitments of \$84,760 and \$2,200,383, or approximately 12.7 percent and 66.0 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.

**NOTE 12. SHARE REPURCHASE PROGRAM**

On August 6, 2015, our Board of Directors authorized a repurchase of up to \$2.5 million of the Company's common stock in the open market within a six-month period. Under the repurchase program, we may, but we are not obligated to, repurchase our outstanding common stock in the open market from time to time provided that we comply with the prohibitions under our Insider Trading Policies and Procedures and the guidelines specified in Rule 10b-18 of the Securities Exchange Act of 1934, as amended, including certain price, market volume and timing constraints. In addition, any repurchases are conducted in accordance with the 1940 Act. During the year ended December 31, 2015, we repurchased 509,082 shares at an average price of approximately \$2.36 per share, inclusive of commissions. This represented a discount of approximately 18.1 percent of the net asset value per share at December 31, 2015. The total dollar amount of shares repurchased in this period was \$1,199,994, leaving a maximum of \$1,300,006 available for future program purchases as of December 31, 2015. The six-month period expired on February 6, 2016. On March 3, 2016, our Board of Directors reauthorized the repurchase of up to \$2.5 million of the Company's common stock within a six-month period. As of March 31, 2016, no additional repurchases have occurred, leaving a maximum of \$2.5 million available for future repurchases.

**NOTE 13. CHANGE IN NET ASSETS PER SHARE**

The following table sets forth the computation of basic and diluted per share net increases (decreases) in net assets resulting from operations for the three months ended March 31, 2016, and March 31, 2015.

	For the Three Months Ended March 31,	
	2016	2015
Numerator for decrease in net assets per share resulting from operations	\$ (6,049,614 )	\$ (3,922,038 )
Denominator for basic weighted average shares	30,845,754	31,280,843
Basic net decrease in net assets per share resulting from operations	\$ (0.20 )	\$ (0.13 )
Denominator for diluted weighted average shares	30,845,754	31,280,843
Diluted net decrease in net assets per share resulting from operations	\$ (0.20 )	\$ (0.13 )

Anti-dilutive shares by type:

Stock Options	1,402,912	1,413,412
Restricted Stock <sup>1</sup>	139,329	268,496
Total anti-dilutive shares	1,542,241	1,681,908

<sup>1</sup>A total of 713,000 and 893,000 market-based shares of restricted stock were outstanding during each of the three months ended March 31, 2016, and March 31, 2015, respectively. 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 three months ended March 31, 2016, and March 31, 2015, 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 14. RELATED PARTY TRANSACTIONS**

As a BDC, we provide managerial assistance to our portfolio companies. In certain cases, we earn fees for providing such assistance. During the three months ended March 31, 2016, and March 31, 2015, we earned fees totaling \$146,877 and \$7,000, respectively.

**NOTE 15. SUBSEQUENT EVENTS**

On April 7, 2016, the Company made a \$500,000 follow-on investment in NGX Bio, Inc., a privately held portfolio company.

On April 13, 2016, the Company made a \$550,290 follow-on investment in Lodo Therapeutics Corporation, a privately held portfolio company.

On April 20, 2016, the Company received proceeds of \$390,492 from funds held in escrow relating to the sale of Molecular Imprints, Inc.'s semiconductor lithography equipment business to Canon, Inc.

On April 22, 2016, the Company made a \$225,000 initial investment in Fleet Health Alliance, LLC, a privately held portfolio company.

On May 4, 2016, the Company made a \$150,000 initial investment in AgTech Accelerator Corporation, a privately held portfolio company.



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

	Three Months Ended March 31,			
	2016		2015	
Per Share Operating Performance				
Net asset value per share, beginning of period	\$2.88		\$3.51	
Net operating loss*	(0.04	)	(0.07	)
Net realized loss on investments*	(0.15	)	(0.01	)
Net increase in unrealized depreciation on investments and written call options*(1)	(0.01	)	(0.05	)
Share of loss on equity method investment(2)	0.00		0.00	
Total from investment operations*	(0.20	)	(0.13	)
Net (decrease) increase as a result of stock- based compensation expense*	(0.01	)	0.01	
Total (decrease) increase from capital stock transactions	(0.01	)	0.01	
Net increase as a result of other comprehensive income*(2)	0.00		0.00	
Net (decrease) in net asset value	(0.21	)	(0.12	)
Net asset value per share, end of period	\$2.67		\$3.39	
Stock price per share, end of period	\$1.65		\$3.08	
Total return based on stock price	(25.00	)%	4.41	%
Supplemental Data:				
Net assets, end of period	\$82,505,245		\$105,892,734	
Ratio of expenses, excluding taxes, to average net assets(3)	1.71	%	2.02	%
Ratio of expenses, including taxes, to average net assets(3)	1.72	%	2.02	%
Ratio of net operating loss to average net assets(3)	(1.36	)%	(1.89	)%

Average debt outstanding	\$5,000,000	\$55,556
Average debt per share	\$0.16	\$0.00
Number of shares outstanding, end of period	30,845,754	31,280,843

\*Based on average shares outstanding

<sup>(1)</sup>Net unrealized gains (losses) includes rounding adjustments to reconcile change in net asset value per share. See "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" for a description of unrealized losses on investments.

<sup>(2)</sup>Amounts listed as zero are amounts calculated as less than \$0.005.

<sup>(3)</sup>Not annualized.

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

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

The information contained in this section should be read in conjunction with the Company's unaudited March 31, 2016, Consolidated Financial Statements and the Company's audited 2015 Consolidated Financial Statements and notes thereto.

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

This Quarterly Report on Form 10-Q 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 Quarterly 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 Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission ("SEC"), including our Annual Report on Form 10-K for the year ended December 31, 2015.

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 Quarterly Report on Form 10-Q 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 Quarterly Report on Form 10-Q. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q.

## **Background**

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

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

## **Overview**

We build transformative companies enabled by disruptive science by identifying and investing in such companies and then providing strategic, operational and management resources, and creative financial solutions.

We believe we provide four core benefits to our shareholders. First, we provide shareholders with access to disruptive science-enabled companies, particularly ones that are targeting opportunities in the precision health and precision medicine markets that would otherwise be difficult to access or inaccessible for most current and potential shareholders. Second, we have an existing portfolio of companies in exciting markets at varying stages of maturity that provide for a potential pipeline of investment returns over time. Third, we provide access for accredited investors to co-invest with us in our portfolio companies through our pre-emptive rights. Fourth, we are able to invest opportunistically in a range of types of securities to take advantage of market inefficiencies.

We believe our future growth will be driven by building companies that are targeting the growing market of precision health and precision medicine. We believe that by operating these precision health and precision medicine companies as controlled partner companies rather than as traditional venture capital investments, we can provide more meaningful growth for our shareholders. Our team is already actively engaged in this market and in operating these companies.

### **Precision Health and Precision Medicine**

We define precision health as a focus on preventative care and well-being at the individual level. It includes medical technologies, digital technologies, genetic and biochemical technologies, and machine learning technologies that permit individuals to take control of their health and well-being at all stages of their lives, especially ahead of the period in their lives when chronic disease becomes more prevalent and even potentially dominant. Our specific expertise is in areas where phenotypic or environmental information is intersecting with genotypic information.

We believe the best way to generate value for our shareholders is to operate these companies as majority-owned subsidiaries or controlled portfolio companies where we are actively involved, influencing development through board representation and management support, in addition to the influence we exert through our equity ownership. This level of control and influence was difficult for us to maintain and exert while making traditional venture capital investments owing to our relatively small asset base as compared with other venture capital investors. We believe our ability to be a long-term, patient partner that can generate returns on invested capital through dividends, consulting income, fee income and other sources of cash flows in addition to the sale of our securities of our investee companies is a competitive advantage for us and provides flexibility in how we build and invest in companies.

As of March 31, 2016, we had nine portfolio companies focused on the precision health and precision medicine market. We had controlling positions in four of these nine companies.

### **Review of First Quarter 2016**

During the first quarter of 2016, we continued to take steps to position the Company for potential future growth. We believe a number of accomplishments by our portfolio companies during the quarter have the potential to contribute to this goal. These accomplishments include:

We increased our investment income by 111 percent and decreased our net operating loss by 43 percent during the first quarter of 2016 as compared with the first quarter of 2015;

D-Wave Systems, Inc., EchoPixel, Inc., and Magic Leap, Inc., raised rounds of capital from new and current investors at higher prices per share than each company's prior round of financing;



We founded a new company, Interome, Inc., that is focused on exciting opportunities in precision health and precision medicine. We currently control and manage Interome, leveraging existing resources within Harris & Harris Group to help build the company;

We launched H&H Co-Investment Partners, LLC, an entity formed to provide shareholders who are accredited investors and other accredited investors the opportunity to invest alongside us in our portfolio companies on an individual portfolio company basis;

Mersana Therapeutics, Inc., expanded its partnership with Takeda Pharmaceutical Company Limited. Mersana will receive an upfront payment of \$40 million and an additional payment of \$20 million upon clearance of the IND (Investigational New Drug application) for XMT-1522 by the FDA. Subject to the success of the XMT-1522 and antibody-drug conjugate programs, Mersana is eligible to receive milestone payments of more than \$750 million combined as well as royalties. Takeda will also invest up to \$20 million in equity in future rounds of Mersana financing.

Ensemble Therapeutics Corporation announced that it had achieved a milestone related to its partnership with Alexion; and

Metabolon, Inc., and SYNLAB Group formed a commercialization collaboration for its Quantose IR diagnostic test.

We also faced the following challenges during this quarter:

- Net asset value per share decreased from \$2.88 as of December 31, 2015, to \$2.67 as of March 31, 2016;

Our share price decreased from \$2.20 as of December 31, 2015, to \$1.65 as of March 31, 2016, and \$1.73 as of May 6, 2016;

The values of public equities, particularly those of microcapitalization companies, are highly volatile. The price per share and market capitalization of Adesto Technologies Corporation, Champions Oncology, Inc., Enumeral Biomedical Holdings, Inc., and OpGen, Inc., decreased in value during the first quarter of 2016 as compared with the end of 2015. Additionally, the values of public market comparable companies that are inputs in determining the values of certain of our portfolio companies also decreased during the quarter. Our own stock price has been under considerable pressure from these and other headwinds;

Even though the financings of some of our portfolio companies may have occurred at increases in price per share from prior rounds of financing, such increases may not be reflected in full in our values owing to other rights and preferences afforded to investors in those rounds of financing. This challenge, in part, limited the positive potential

contribution to our net asset value per share by companies that completed such rounds of financing during the first quarter of 2016;

70

Two of our portfolio companies, Cambrios Technologies Corporation and Ultera, Inc., completed auctions of their respective assets by a trustee appointed to conduct such liquidations for the benefit of creditors. We did not receive any proceeds from the liquidation of assets of either company; and

While Bridgelux, Inc., agreed to be acquired by a consortium of buyers in July of 2015, the transaction has yet to close, and we are uncertain if and when it will close.

## **Portfolio Summary**

As of March 31, 2016, we had 21 privately held, equity-focused companies in our portfolio that have yet to complete liquidity events (e.g., public listings or merger and acquisition ("M&A") transactions and are not in the process of liquidating their assets. These do not include 1) our publicly traded and unrestricted securities of Champions Oncology, Inc., Enumeral Biomedical Holdings, Inc. and OpGen, Inc.; 2) our publicly traded securities of Adesto Technologies Corporation, which are subject to restrictions on their sale; 3) our investment in NanoTerra, Inc., which was originally structured as a venture debt investment; 4) our rights to milestone payments from Amgen, Inc., Laird Technologies, Inc., and Canon, Inc.; 5) our portfolio company, Laser Light Engines, Inc., which is in the process of liquidating its assets and/or has shut down; 6) our portfolio companies, Black Silicon Holdings, Inc., and SynGlyco, Inc., that exist to collect payments from the sale of subsidiaries or assets; and 7) our portfolio company, Bridgelux, Inc., which has entered into an acquisition agreement. As of March 31, 2016, we valued these 21 privately held equity-focused companies at \$53,887,115. Including the companies referenced above, we valued our total portfolio at \$73,521,729 as of March 31, 2016.

## **Summary of Returns**

Since our investment in Otisville in 1983 through March 31, 2016, we have made a total of 108 equity-focused investments. We have completely exited 78 and partially exited two of these 108 investments, recognizing aggregate net realized gains of \$84,224,913 on invested capital of \$140,554,886, or 1.6 times invested capital. For the securities of the 25 privately held companies in our equity-focused portfolio held at March 31, 2016, we have net unrealized depreciation of \$32,005,053 on invested capital of \$87,963,977. We have aggregate net realized gains on our exited companies, offset by unrealized depreciation for our 25 currently held equity-focused investments of \$52,219,860 on invested capital of \$228,518,863. The above net realized gains do not take into consideration our annual operating expenses over the period from 1983 to March 31, 2016, which expenses are directly or indirectly borne by our shareholders. At March 31, 2016, from first dollar in, the average and median holding periods for the 25 privately held equity-focused investments were 5.2 years and 4.6 years, respectively. Historically, as measured from first dollar in to last dollar out, the average and median holding periods for the 78 investments we have fully exited were 4.6 years and 3.6 years, respectively.

The amount of net realizations includes the following exits in the first quarter of 2016:

- Realized loss of \$3,418,349 on our investment in Cambrios Technologies Corporation.
- Realized loss of \$1,244,955 on our investment in Ultora, Inc.

The aggregate net realized gains and the cumulative invested capital do not reflect the cost or value of our freely tradable shares of Champions Oncology, Inc., Enumeral Biomedical Holdings, Inc., or OpGen, Inc., that we owned as of March 31, 2016. 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 March 31, 2016, our aggregate net realized gains and cumulative invested capital from 1983 through March 31, 2016, would be \$80,437,855 and \$153,618,443, respectively, or 1.5 times invested capital. These amounts also do not include our shares of Adesto Technologies Corporation that, while traded publicly, are restricted. Adesto is considered an affiliated company, and we are subject to a lock-up agreement.

### **Recent and Potential Liquidity Events From Our Portfolio as of March 31, 2016**

On April 18, 2014, Canon, Inc., completed its acquisition of Molecular Imprints, Inc.'s semiconductor lithography equipment business. On October 1, 2015, the Company received proceeds of \$795,567 upon the achievement of the first milestone associated with this transaction. As of March 31, 2016, we valued the remaining potential milestone payments from the sale of Molecular Imprints at \$464,073. On April 20, 2016, the Company received proceeds of \$390,492 from the release of a portion of the funds held in escrow following the transaction. We could receive an additional \$234,000 from amounts held in escrow as well as up to \$938,926 upon the achievement of certain additional milestones. There can be no assurance as to the timing and how much of the remaining 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 to continue development and commercialization of nanoscale patterning in consumer and biomedical applications, and we became a shareholder of the new company.

On May 1, 2015, this new spin-out of Molecular Imprints, Inc.'s non-semiconductor business was acquired. Upon closing of the transaction, we received our initial payment of \$705,794 and 24,897 shares of Series B Preferred Stock of the acquiring company. As of March 31, 2016, additional proceeds of \$126,972 and 4,394 shares of Series B Preferred Stock of the acquiring party are held in an indemnity escrow and \$3,386 is held in a stockholder representative funding escrow until May 1, 2016. As of March 31, 2016, we valued the funds and the shares of stock held in escrow from the sale of Molecular Imprints at \$126,972 and \$93,616, respectively.

As of March 31, 2016, we valued the remaining potential milestone payments from the sale of BioVex Group, Inc., at \$2,495,696. If all the remaining milestone payments were to be paid by Amgen, Inc., we would receive an additional \$4,141,910. There can be no assurance as to the timing and how much of this amount we will ultimately realize in the future.

In July 2015, SynGlyco negotiated the acceleration and settlement of payments due to it from the sale of its synthesis business to Corden Pharmaceuticals. This acceleration of payments yielded proceeds that paid off in full our senior

secured debt investment with a payment to us of \$567,500. We received additional repayments for our outstanding secured convertible bridge notes of approximately \$750,000 during the first quarter of 2016. Additionally, SynGlyco entered into two license agreements that may provide additional payments in the future. These payments may bring our total cash distributions from this investment to approximately \$1.7 million. We invested a total of \$8.8 million in SynGlyco, beginning with our initial investment in 2007 and valued our securities of the company at \$156,432 as of March 31, 2016.

On July 21, 2015, Bridgelux signed a definitive agreement to be acquired by an investment group led by China Electronics Corporation and ChongQing Linkong Development Investment Company. The timing of the close of this transaction remains uncertain.

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.

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

Our current portfolio is comprised of 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 25 equity-focused companies in our portfolio that are not in the process of being sold or shut down are shown in the figure below (our "Active Portfolio").

\* Indicates publicly traded company as of March 31, 2016.

Note: Equity-focused portfolio companies and stage classifications as of March 31, 2016, not including 1) our rights to milestone payments associated with the acquisitions of BioVex Group, Nextreme Thermal Solutions and Molecular Imprints; and 2) portfolio companies currently in the process of being liquidated or sold, have ceased or are in the process of ceasing operations and/or are seeking a sale of their assets, including Laser Light Engines, SynGlyco, Bridgelux, and Black Silicon Holdings.

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 categorize our new portfolio company, Interome, Inc., as an early-stage company.

### 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 currently believe the potential value at exit is substantial. The table below provides some additional detail on our ownership of the 21 privately held, equity-focused companies in our portfolio that have yet to complete liquidity events (e.g., public listings or M&A transactions) and are not in the process of liquidating their assets. Phylagen, Inc., which we consider an equity-focused company, is not included in the chart below. Our ownership of Phylagen is solely in a note in a series seed financing for which we do not have any voting rights.

<b>Portfolio Company</b>	<b>Voting Ownership Range</b>
EchoPixel, Inc.	
Interome, Inc.*	
NGXBio, Inc.*	>20%
Produced Water Absorbents, Inc.	
ProMuc, Inc.*	
Senova Systems, Inc.*	
ABSMaterials, Inc.	
TARA Biosystems, Inc.*	15-20%
HZO, Inc.	
ORIG3N, Inc.	10-15%
Accelerator IV-New York Corporation	5-10%
AgBiome, L.L.C.	
Ensemble Therapeutics Corp.	
Metabolon, Inc.	



Petra Pharma Corp.

Mersana Therapeutics, Inc. 2.5-5%

D-Wave Systems, Inc.\*\*

Lodo Therapeutics Corp. 0-2.5%

Magic Leap, Inc.

Nanosys, Inc.

\*Denotes a controlled affiliated company.

\*\*We own voting and non-voting classes of preferred equity of D-Wave Systems, Inc. If the non-voting preferred equity was included in the calculation, our ownership of D-Wave would be in the 2.5-5% range.

### 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 March 31, 2016, we held at least one board seat or observer rights on 18 of our 21 equity-focused portfolio companies that have yet to complete a liquidity event or public listing and are not in the process of being shut down or have not agreed to be acquired (86 percent).

### Investments and Current Investment Pace

The following is a summary of our initial and follow-on equity-focused investments from January 1, 2012, to March 31, 2016. 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

	2012	2013	2014	2015	Three Months Ended March 31, 2016
Total Incremental Investments	\$15,141,941	\$18,076,288	\$14,276,808	\$11,963,021	\$ 2,253,692
No. of New Investments	2	2	3	4	1
No. of Follow-On Investment Rounds	26	37	33	31	6
No. of Rounds Led	3	9	8	8	1
Average Dollar Amount – Initial	\$1,407,500	\$550,001	\$338,677	\$395,738	\$ 300,010
Average Dollar Amount – Follow-On	\$474,113	\$449,359	\$401,842	\$334,841	\$ 325,613

### 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 March 31, 2016, and December 31, 2015, our total primary and secondary liquidity was \$28,644,681 and

\$37,053,638, respectively. We do not include funds available and undrawn 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 and certain receivables. As of March 31, 2016, we held \$14,311,324 in cash and \$191,036 in certain receivables. As of December 31, 2015, we held \$17,922,630 in cash and \$30,427 in certain receivables.

During the three months ended March 31, 2016, we received proceeds of \$750,000 from the repayment of certain bridge notes in SynGlyco, Inc., proceeds of \$113,950 from the repayment of a bridge note in EchoPixel, Inc., and \$42,085 in fees for providing managerial assistance to certain portfolio companies. These proceeds added to our primary liquidity during the three months ended March 31, 2016. Future payments upon achieving milestones from the sale of BioVex Group, Inc., and the sale of Molecular Imprints, Inc., to Canon, Inc., would also add to our primary liquidity 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. As of March 31, 2016, our secondary liquidity was \$14,142,321. Champions Oncology, Inc., accounts for \$933,232 of the total amount of secondary liquidity based on the volume weighted average price of its common stock during the quarter ended March 31, 2016. Adesto Technologies Corporation, Enumeral Biomedical Holdings, Inc., and OpGen, Inc., account for \$9,946,658, \$1,274,619 and \$1,987,812, respectively, of the total amount of secondary liquidity based on the closing price of their common stock as of March 31, 2016. We were subject to lock-up agreements restricting our ability to trade our securities of Enumeral Biomedical Holdings and Adesto Technologies, exclusive of the general restriction on the transfer of unregistered securities, as of December 31, 2015. The lock-up period on our 7,966,368 shares and warrants for the purchase of 1,755,120 shares of common stock of Enumeral Biomedical Holdings expired on January 31, 2016. The lock-up period on our 1,769,868 shares of common stock of Adesto Technologies expired on April 25, 2016.

As of December 31, 2015, our secondary liquidity was \$19,100,581. Champions Oncology, Inc., accounted for \$944,819 of the total amount of secondary liquidity based on the volume weighted average price of its common stock during the quarter ended December 31, 2015. Adesto Technologies Corporation, Enumeral Biomedical Holdings, Inc., and OpGen, Inc., accounted for \$13,645,682, \$1,831,468 and \$2,678,612, respectively, of the total amount of secondary liquidity based on the closing price of their common stock as of December 31, 2015.

We also have the \$20,000,000 Loan Facility, which we can draw on to increase liquidity. As of March 31, 2016, we had \$5,000,000 in debt outstanding relating to this Loan Facility.

### **Current Business Environment**

The success of our business is predicated on our ability to build companies that provide returns on our invested capital through increases in value of our ownership of those companies, through realized returns generated through the sale of our securities of those companies and, currently to a lesser extent, through short-term income generated from our involvement with those companies. All of these factors can be affected by the current business environment.

Our ability to increase the value of our ownership in our investee companies requires that the current business environment be favorable for the companies to be able to execute on their business and attract additional capital at progressively lower costs over time. These two factors may not necessarily be linked as, more often than not, the price of capital is determined by new investors, and there may not be competition that would provide the company with more leverage in negotiations of price and terms. This situation is especially impactful in private financings and public financings of small capitalization companies where there are limited investors from which to raise capital. The IPO of our portfolio company, Adesto Technologies Corporation, is an example of this situation where the values of publicly

traded comparable companies were substantially above the value at which Adesto was able to raise capital in the transaction. We believe this situation will continue for the foreseeable future given the decrease in investors willing to invest in small capitalization companies. That said, certain companies will continue to raise capital at increasing valuations and under favorable terms, and for such companies, the current business environment can be supportive of such events.

Even if a company raises additional capital, our participation may be limited owing to our available capital. These situations are occurring more frequently, particularly as the types of companies in which we invest are raising large rounds of financing from deep-pocketed investors. The impact to us is dilution, which may affect value and our ultimate returns, and loss of control. The current business environment is dominated by such large funds, which make it difficult for us to maintain ownership and control in certain companies. This factor is part of the reason for our shift in focus to build companies that we can finance and control with our available capital and investments that produce income where our returns are not as impacted by dilution or loss of control.

The most pronounced issue for certain of our portfolio companies in terms of execution related to the current business environment is the continued pressure on the price of oil. Our exposure to this market is limited to our investment in Produced Water Absorbents, Inc., which is valued at approximately two percent of our total assets.

Our ability to generate realized returns through the sale of the securities of our investee companies is impacted by the values of publicly traded companies, particularly microcapitalization companies and the global environment for M&A transactions. The valuations of microcapitalization indices decreased during the first quarter of 2016. According to the National Venture Capital Association, the number of IPOs were at its lowest since the third quarter of 2011, and M&A transactions decreased by 19 percent compared with the first quarter of 2015. We believe the current business environment is relatively risk-adverse, which leads to liquid capital being shifted from risky companies, which are often microcapitalization companies, to less risky companies and results in a decrease in the overall value of those companies. Given the uncertainty over future interest rates, the U.S. election, the oil and gas markets, and the global economy, particularly in China, we expect that the values of microcapitalization companies will continue to be volatile and under pressure, which may affect our ability to monetize our positions in our publicly traded portfolio companies and the value which is ultimately realized from these investments.

Our short-term income is generated through interest income from convertible and non-convertible debt investments, yield-enhancing fees on debt investments and fees for providing managerial assistance to our investee companies. We believe the current business environment is supportive for us to be able to continue to generate income from these sources as the majority of such income comes from securities or engagements with companies outside of the oil and gas industries and is associated with companies that we control.

### **Valuation of Investments**

We value our privately held investments and certain publicly traded investments that are determined to not trade in an active market 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 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.

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.

Four of our portfolio companies trade in public exchanges and are subject to the volatility inherent in the public markets. The following table illustrates the range of values of these securities.

#### Public Companies' Trading History

	<b>Price per Share on May 6, 2016</b>	<b>Q1 2016 Trading Range</b>	<b>H&amp;H Ownership Value in Q1 2016 Trading Range*</b>	<b>January - December 2015 Trading Range</b>	<b>H&amp;H Ownership Value in January - December 2015 Trading Range*</b>
Adesto Technologies Corporation	\$ 3.23	\$4.94 - \$7.81	\$8.7 - \$13.8 Million	\$5.00 - \$8.50	\$8.8 - \$15.0 Million
Champions Oncology, Inc.**	\$ 4.05	\$3.23 - \$4.30	\$0.8 - \$1.0 Million	\$2.40 - \$9.00	\$0.6 - \$2.2 Million
Enumeral Biomedical Holdings, Inc.	\$ 0.19	\$0.16 - \$0.29	\$1.3 - \$2.3 Million	\$0.18 - \$1.07	\$1.4 - \$8.5 Million
OpGen, Inc.	\$ 1.14	\$1.36 - \$1.97	\$1.9 - \$2.8 Million	\$1.45 - \$5.44	\$2.0 - \$7.7 Million
Total:			\$12.7 - \$19.9 Million		\$12.8- \$33.4 Million

\*Calculated based on common shares held as of March 31, 2016.

\*\*On August 12, 2015, Champions Oncology effected a 12:1 reverse stock split; trading range reported on a split-adjusted basis.

In each of the years in the period of 2012 through 2015 and for the three months ended March 31, 2016, 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**

	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>Three Months Ended March 31, 2016</b>
Net Asset Value, BOY	\$ 145,698,407	\$ 128,436,774	\$ 122,701,575	\$ 109,654,427	\$ 88,711,671
Gross Write-Downs During Year	\$(19,604,046 )	\$(19,089,816 )	\$(14,050,501 )	\$(15,710,180 )	\$ (5,186,202 )
Gross Write-Ups During Year	\$ 14,099,904	\$ 10,218,994	\$ 4,587,923	\$ 6,628,025	\$ 5,511,178
Gross Write-Downs as a Percentage of Net Asset Value, BOY	(13.5 )%	(14.9 )%	(11.5 )%	(14.3 )%	(5.8 )%
Gross Write-Ups as a Percentage of Net Asset Value, BOY	9.7 %	8.0 %	3.8 %	6.0 %	6.2 %
Net Change as a Percentage of Net Asset Value, BOY	(3.8 )%	(6.9 )%	(7.7 )%	(8.3 )%	0.4 %

From December 31, 2015, to March 31, 2016, the value of our equity-focused 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 \$3,637,663, from \$77,090,715 to \$73,453,052.

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 \$3,235,381 from \$73,728,664 to \$70,493,283.

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 our unrestricted or registered shares of Enumeral Biomedical Holdings, Inc., which trade on an OTC exchange, or the value of our unrestricted shares of Adesto Technologies Corporation or the unrestricted or registered shares and a portion of our warrants for the purchase of common stock of OpGen, Inc., which both trade on the NASDAQ Capital Market. For the fourth quarter of 2015, our Valuation Committee set the value of Champions Oncology, Inc., owing to the determination that it did not trade in an active market.

Five portfolio companies, Adesto Technologies Corporation, Metabolon, Inc., Senova Systems, Inc., Produced Water Absorbents, Inc., and OpGen, Inc., accounted for \$8.5 million, or 83 percent, of the gross write-downs of our portfolio companies held as of March 31, 2016.

The change in value of Adesto Technologies Corporation and OpGen, Inc. was owing to decreases in the price per share of each company's publicly traded stock. We note that a portion of our securities of OpGen and all of our shares of Adesto were not fair valued by the Valuation Committee as of March 31, 2016, because those securities were registered, unrestricted securities that traded in an active market and were, therefore, valued based on the closing price of the shares on the date of valuation. The primary contributing factor for the decrease in valuation of OpGen was a decrease in the stock price of the company from \$1.90 as of December 31, 2015, to \$1.41 as of March 31, 2016. The primary contributing factor for the decrease in valuation of Adesto was a decrease in the stock price of the company from \$7.71 as of December 31, 2015, to \$5.62 as of March 31, 2016.

The primary contributing factor for the decrease in valuation of Metabolon, Inc., was the decrease of multiples of revenues of publicly traded comparable companies used to derive the value of our securities of the company, offset, in part, by an increase in its revenues on a twelve-month trailing basis. The primary contributing factor for the decrease in valuation of Produced Water Absorbents, Inc., was the continued market downturn in the oil and gas industries.

The primary contributing factor for the decrease in valuation of Senova Systems, Inc., was the shift in the valuation methodology from a value based on the previous round of financing to a value based on a discounted cash flow analysis.

Three portfolio companies, D-Wave Systems, Inc., HZO, Inc., and Magic Leap, Inc., accounted for \$5.2 million or 94 percent of the gross write-ups of our portfolio companies held as of March 31, 2016.

The primary contributing factor for the increase in valuation of D-Wave Systems, Inc., was the terms of the round of financing closed at the end of the first quarter of 2016.

The primary contributing factor for the increase in valuation of HZO, Inc., was an increase in the volatility of publicly traded comparable companies and the effect this increase has on derivation and allocation of value based on option pricing models.

The primary contributing factor for the increase in valuation of Magic Leap, Inc., was the terms of the sale of the Company's shares of Magic Leap to an undisclosed buyer.

As of March 31, 2016, our top ten investments by value accounted for approximately 79 percent of the value of our equity-focused portfolio.

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

Portfolio Company	Value as of 03/31/2016	Cumulative % of Equity Focused Venture Capital Portfolio
D-Wave Systems, Inc.	\$ 11,539,147	16%

Metabolon, Inc.	\$ 11,078,071	32%
Adesto Technologies Corp.*	\$ 9,946,658	46%
HZO, Inc.	\$ 7,418,321	57%
AgBiome, L.L.C.	\$ 5,655,517	65%
Ensemble Therapeutics Corp.	\$ 2,145,390	68%
OpGen, Inc.*	\$ 2,088,420	71%
TARA Biosystems, Inc.	\$ 2,063,050	74%
EchoPixel, Inc.	\$ 1,839,059	76%
Bridgelux, Inc.	\$ 1,821,390	79%

\* Adesto Technologies and OpGen ranks by value include the value of their 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 three months ended March 31, 2016, and March 31, 2015, we did not hold any U.S. government securities.

*Three months ended March 31, 2016, as compared with the three months ended March 31, 2015*



In the three months ended March 31, 2016, and March 31, 2015, we had net decreases in net assets resulting from operations of \$6,049,614 and \$3,922,038, respectively.

Investment Income and Expenses:

We had net operating losses of \$1,161,926 and \$2,036,345 for the three months ended March 31, 2016, and March 31, 2015, respectively. The variation in these results is primarily owing to the changes in investment income and operating expenses, including non-cash expense, net of forfeitures, included in salaries, benefits and stock-based compensation of \$(104,566) in 2016 primarily associated with the compensation cost for restricted stock as compared with \$212,591 for the same period in 2015. During the three months ended March 31, 2016, and 2015, total investment income was \$302,042 and \$142,832, respectively. During the three months ended March 31, 2016, and 2015, total operating expenses were \$1,463,968 and \$2,179,177, respectively.

During the three months ended March 31, 2016, as compared with the same period in 2015, investment income increased, reflecting increases in fees for providing managerial assistance to portfolio companies and interest income from convertible bridge notes and non-convertible promissory notes, offset by decreases in yield-enhancing fees on debt securities. Our fees for providing managerial assistance to portfolio companies of \$146,877 for the three months ended March 31, 2016, include \$100,000 earned from Interome, Inc., a newly founded portfolio company that we currently control and manage, pursuant to a consulting agreement between the Company and Interome executed during the first quarter and expiring on December 31, 2016. This consulting agreement is expected to provide the Company with \$900,000, in aggregate, in fees for providing managerial assistance to Interome for 2016. During the three months ended March 31, 2016, and March 31, 2015, we did not hold any U.S. government securities 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 expense, were \$1,463,968 and \$2,179,177 for the three months ended March 31, 2016, and March 31, 2015, respectively. The decrease in operating expenses for the three months ended March 31, 2016, as compared with the three months ended March 31, 2015, was primarily owing to decreases in salaries, benefits and stock-based compensation expense, professional fees, rent expense, insurance expense, directors' fees and expenses and custody fees, offset by increases in administration and operations expense and interest and other debt expense.

Salaries, benefits and stock-based compensation expense decreased by \$474,581, or 44.0 percent, for the three months ended March 31, 2016, as compared with March 31, 2015, primarily as a result of a decrease in salaries and benefits owing primarily to a decrease in our employee headcount, a decrease of \$60,250 in employee bonus expense and a decrease in compensation cost of \$317,157 for restricted stock awards associated with the Stock Plan. At March 31, 2016, we had seven full-time employees and one part-time employee as compared with 10 full-time employees and one part-time employee at March 31, 2015. Professional fees decreased by \$273,412, or 47.8 percent, for the three months ended March 31, 2016, as compared with March 31, 2015, primarily as a result of a decrease in certain legal, consulting and accounting fees. Rent expense decreased by \$10,486, or 15.5 percent, for the three months ended March 31, 2016, as compared with March 31, 2015. Our rent expense of \$57,220 for the three months ended March 31, 2016, includes \$71,639 of rent paid in cash, net of \$14,419 non-cash rent expense, credits and abatements that we recognize on a straight-line basis over the lease term. Insurance expense decreased by \$8,036, or 11.9 percent, for the three months ended March 31, 2016, as compared with March 31, 2015. Directors' fees and expenses decreased by \$49,015, or 41.0 percent, for the three months ended March 31, 2016, as compared with March 31, 2015, primarily owing to additional meetings held the Board of Directors during the comparable period in 2015. Custody fees decreased by \$3,851, or 24.2 percent, for the three months ended March 31, 2016, as compared with March 31, 2015.

Administration and operations expense increased by \$41,058, or 40.6 percent, for the three months ended March 31, 2016, as compared with March 31, 2015, primarily as a result of timing differences related to certain accrued expenses, offset by decreases in managing directors' travel-related expenses and net decreases in general office and administration expenses. Interest and other debt expense increased by \$64,306, or 44.7 percent, for the three months ended March 31, 2016, as compared with March 31, 2015, primarily as a result of utilization fees associated with a drawdown of the Loan Facility.



Realized Gains and Losses from Investments:

During the three months ended March 31, 2016, and March 31, 2015, we realized net losses on investments of \$4,403,948 and \$283,301, respectively.

During the three months ended March 31, 2016, we realized net losses of \$4,403,948 consisting of a realized loss of \$3,418,349 on our investment in Cambrios Technologies Corporation and a realized loss of \$1,244,955 on our investment in Ultora, Inc., offset by a realized gain of \$195,812 on our escrow payment from the sale of our investment in Molecular Imprints, Inc., to Canon, Inc., and a realized gain of \$63,544 on our escrow payment from the sale of our investment in Molecular Imprints, Inc., to Magic Leap, Inc.

During the three months ended March 31, 2015, we realized net losses of \$283,301 consisting primarily of a realized loss of \$293,786 on our investment in Metabolon, Inc., owing to the expiration of certain warrants, offset by a realized gain of \$8,942 on the sale of certain warrants of GEO Semiconductor, Inc., and a realized gain of \$1,543 on our escrow payment from the sale of Molecular Imprints, Inc.

Net Unrealized Appreciation and Depreciation of Portfolio Securities:

During the three months ended March 31, 2016, net unrealized depreciation on total investments increased by \$436,428, or less than one percent, from accumulated net unrealized depreciation of \$39,909,204 at December 31, 2015, to accumulated net unrealized depreciation of \$40,345,632 at March 31, 2016. During the three months ended March 31, 2015, net unrealized depreciation on total investments increased by \$1,470,781, or 6.5 percent, from accumulated net unrealized depreciation of \$22,606,475 at December 31, 2014, to accumulated net unrealized depreciation of \$24,077,256 at March 31, 2015.

During the three months ended March 31, 2016, net unrealized depreciation on our venture capital investments increased by \$436,428, from net unrealized depreciation of \$39,909,204 at December 31, 2015, to net unrealized depreciation of \$40,345,632 at March 31, 2016, owing to write-downs in the valuations of the following portfolio company investments:

Investment	Amount of Write-Down
Adesto Technologies Corporation	3,699,024

Metabolon, Inc.	2,543,773
Senova Systems, Inc.	822,281
Produced Water Absorbents, Inc.	725,517
OpGen, Inc.	717,995
Bridgelux, Inc.	717,494
Enumeral Biomedical Corp.	592,286
Nanosys, Inc.	178,935
NGX Bio, Inc.	163,795
Black Silicon Holdings, Inc.	20,343
Champions Oncology, Inc.	13,121
SynGlyco, Inc.	12,256
ORIG3N, Inc.	1,336
Mersana Therapeutics, Inc.	472

The write-downs for the three months ended March 31, 2016, were partially offset by write-ups in the valuations of the following portfolio company investments:

Investment	Amount of Write-Ups
D-Wave Systems, Inc.	4,137,420
HZO, Inc.	291,535
Magic Leap, Inc.	275,065
AgBiome, LLC	165,226
Phylagen, Inc.	88,778
Ensemble Therapeutics Corporation	34,488
ABSMaterials, Inc.	20,060
EchoPixel, Inc.	11,967
NanoTerra, Inc.	6,488
TARA Biosystems, Inc.	5,225
Petra Pharma Corporation	3,780
Lodo Therapeutics Corporation	554

In addition to the write-ups listed above, we had a decrease in unrealized depreciation of \$3,418,349 on our investment in Cambrios Technologies Corporation owing to a realized loss on the write-off of its securities.

We had a decrease in unrealized depreciation of \$1,244,955 on our investment in Ultora, Inc., owing to a realized loss on the write-off of its securities.

We had a decrease in unrealized depreciation of \$470,592 on our investment in D-Wave Systems, Inc., owing to foreign currency translation.

We had a decrease in unrealized depreciation of \$2,254 on the rights to milestone payments from Canon, Inc.'s acquisition of Molecular Imprints, Inc.

We had an increase in unrealized depreciation of \$404,536 on the rights to milestone payments from Amgen, Inc.'s acquisition of BioVex Group, Inc.

During the three months ended March 31, 2015, net unrealized depreciation on our venture capital investments increased by \$1,470,781, from net unrealized depreciation of \$22,606,475 at December 31, 2014, to net unrealized depreciation of \$24,077,256 at March 31, 2015 owing to write-downs in the valuations of the following portfolio company investments:

Investment	Amount of Write-Down
Produced Water Absorbents, Inc.	\$ 3,724,565
Enumeral Biomedical Holdings, Inc.	1,779,867
Nanosys, Inc.	707,385
Ensemble Therapeutics Corporation	528,000
Metabolon, Inc.	192,473
SiOnyx, Inc.	106,977
Bridgelux, Inc.	98,876
Ultora, Inc.	7,525
UberSeq, Inc.	4,680

The write-downs for the three months ended March 31, 2015, were partially offset by write-ups in the valuations of the following portfolio company investments:

Investment	Amount of Write-Ups
OpGen, Inc.	\$ 3,531,291
Adesto Technologies Corporation	1,353,309
Champions Oncology, Inc.	810,714
Accelerator IV – New York Corporation	164,385
Molecular Imprints, Inc.	157,909
HZO, Inc.	114,794
SynGlyco, Inc.	96,557
Senova Systems, Inc.	60,560
ABSMaterials, Inc.	37,135
EchoPixel, Inc.	16,170
Mersana Therapeutics, Inc.	15,087
Solazyme, Inc.	14,000
Nantero, Inc.	10,391
AgBiome, LLC	8,884
Cambrios Technologies Corporation	5,823
D-Wave Systems, Inc.	2,004
NanoTerra, Inc.	1,087
Orig3n, Inc.	893

We had an increase in unrealized depreciation of \$714,472 on our investment in D-Wave Systems, Inc., owing to foreign currency translation

We had an increase in unrealized depreciation of \$7,870 on our investment in GEO Semiconductor, Inc., owing to a realized gain on the sale of certain warrants.



We had an increase in unrealized depreciation of \$847 on the rights to milestone payments from Amgen, Inc.'s acquisition of BioVex Group, Inc.

We had a decrease in unrealized depreciation of \$1,763 on the rights to milestone payments from Canon, Inc.'s acquisition of Molecular Imprints, Inc.

**Financial Condition**

*March 31, 2016*

At March 31, 2016, our total assets and net assets were \$89,533,370 and \$82,505,245, respectively. At December 31, 2015, our total assets and net assets were \$96,461,286 and \$88,711,671, respectively.

At March 31, 2016, our net asset value per share was \$2.67, as compared with \$2.88 at December 31, 2015. At March 31, 2016, and December 31, 2015, our shares outstanding were 30,845,754.

Significant developments in the three months ended March 31, 2016, included a decrease in the holdings of our venture capital investments of \$3,631,175 and a decrease in our cash of \$3,611,306. The decrease in our venture capital investments from \$77,152,904 at December 31, 2015, to \$73,521,729 at March 31, 2016, resulted primarily from a decrease in the net value of our venture capital investments held of \$5,884,867, offset by new and follow-on investments of \$2,253,692. The decrease in our cash from \$17,922,630 at December 31, 2015, to \$14,311,324 at March 31, 2016, is primarily owing to new and follow-on venture capital investments totaling \$2,253,692 and the payment of cash for operating expenses of \$1,603,353, offset by proceeds of \$750,000 from the repayment of certain bridge notes in SynGlyco, Inc., and proceeds of \$113,950 from the repayment of a bridge note in EchoPixel, Inc.

The following table is a summary of additions to our portfolio of investments made during the three months ended March 31, 2016:

**New Investments** Amount of Investment

Interome, Inc. \$ 300,010

**Follow-On Investments** Amount of Investment

Produced Water Absorbents, Inc. \$ 875,000

EchoPixel, Inc.	500,000
Senova Systems, Inc.	250,000
Produced Water Absorbents, Inc.	125,000
Accelerator IV-New York Corporation	103,680
ABSMaterials, Inc.	100,000
NGX Bio, Inc.	2
Total	\$ 2,253,692

The following table summarizes the value of our portfolio of venture capital investments as compared with its cost at March 31, 2016, and December 31, 2015:

	March 31, 2016	December 31, 2015
Venture capital investments, at cost	\$ 113,867,361	\$ 117,062,108
Net unrealized (depreciation)	(40,345,632 )	(39,909,204 )
Venture capital investments, at value	\$ 73,521,729	\$ 77,152,904

### **Cash Flow**

Net cash used in operating activities for the three months ended March 31, 2016, was \$3,611,306, primarily reflecting the purchase of venture capital investments of \$2,253,692 and the payment of operating expenses of \$1,603,353, offset by proceeds from the sale of investments and repayment of principal of \$863,950.

Net cash used in investing activities for the three months ended March 31, 2016, was \$0.

Net cash provided by financing activities for the three months ended March 31, 2016, was \$0.

Net cash used in operating activities for the three months ended March 31, 2015, was \$4,690,065, primarily reflecting the purchase of venture capital investments of \$2,615,301 and the payment of operating expenses, offset by proceeds from the sale of investments and repayment of principal of \$115,736.

Net cash used in investing activities for the three months ended March 31, 2015, was \$6,806, primarily reflecting the purchase of fixed assets.

Net cash provided by financing activities for the three months ended March 31, 2015, was \$5,000,000, primarily reflecting a partial drawdown from the Loan Facility.

### **Liquidity and Capital Resources**

Our liquidity and capital resources are generated and are generally available through our cash holdings, cash flows from payments received on our venture debt investments, fees received for providing managerial assistance to portfolio companies, proceeds received 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 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 March 31, 2016, and December 31, 2015, 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 March 31, 2016, we had \$5,000,000 in 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 will 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 our ability to adjust our investment pace will provide us with adequate liquidity to execute our current business strategy.

At March 31, 2016, and December 31, 2015, our total primary liquidity was \$14,502,360 and \$17,953,057, respectively. Our primary liquidity is principally comprised of our cash and certain receivables. The decrease in our primary liquidity from December 31, 2015, to March 31, 2016, is primarily owing to new and follow-on venture capital investments totaling \$2,253,692 and the payment of cash for operating expenses of \$1,603,353, offset by proceeds of \$750,000 from the repayment of certain bridge notes in SynGlyco, Inc., and proceeds of \$113,950 from the repayment of a bridge note in EchoPixel, Inc.

At March 31, 2016, and December 31, 2015, our secondary liquidity was \$14,142,321 and \$19,100,581, respectively. Our secondary liquidity consists of our publicly traded securities and does not include the value of warrants we hold in Champions Oncology, Inc., Enumeral Biomedical Holdings, Inc., and OpGen, Inc. 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 March 31, 2016, our publicly traded securities of Adesto Technologies Corporation, Enumeral Biomedical Holdings and OpGen, Inc., were restricted from sale.

As of March 31, 2016, we have \$5,000,000 in debt outstanding.

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 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 March 31, 2016, our net asset value per share was \$2.67 per share and our closing market price was \$1.65 per share. We do not currently have shareholder approval to issue or sell shares below our net asset value per share.

**Borrowings**

On September 30, 2013, the Company entered into the Loan Facility that may be used by the Company to fund investments in portfolio companies. 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.

At March 31, 2016, and December 31, 2015, the Company had \$5,000,000 in debt outstanding. The remaining capacity under the Loan Facility was \$15,000,000 at March 31, 2016.

**Contractual Obligations**

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

**Payments Due by Period**

	Total	Less than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Multi-Draw Loan Facility <sup>(1)</sup>	\$5,761,111	\$506,944	\$5,254,167	\$0	\$0
Operating leases	1,122,998	289,481	600,854	232,663	0
Total	\$6,884,109	\$796,425	\$5,855,021	\$232,663	\$0

<sup>(1)</sup>As of March 31, 2016, we had \$15,000,000 of unused borrowing capacity under our Loan Facility.



Amounts include interest payable assuming \$5,000,000 remains outstanding through the maturity date in 2017.

On July 21, 2014, the Company made an investment in Accelerator IV-New York Corporation ("Accelerator") for a 9.6 percent interest in the company. This investment was diluted to 9.0 percent through follow-on financings by Accelerator in which the Company did not participate. Accelerator will be identifying emerging biotechnology companies for the Company to invest in directly 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, 2015, \$262,215 in capital related to the operating commitment and \$1,132,950 in capital related to the investment commitment was called. During the three months ended March 31, 2016, \$103,680 in capital related to the operating commitment was called. As of March 31, 2016, the Company had remaining unfunded commitments of \$84,760 and \$2,200,383, or approximately 12.7 percent and 66.0 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 3 to the Consolidated Financial Statements and in the Footnote to the Consolidated Schedule of Investments. Critical accounting policies are those that are both important to the presentation of our financial condition and results of operations and those that require management's most difficult, complex or subjective judgments. The Company considers the following accounting policies and related estimates to be critical:

#### **Valuation of Portfolio Investments**

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

Investments are stated at "value" as defined in the 1940 Act and in the applicable regulations of the SEC 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 6. 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 March 31, 2016, our financial statements include investments fair valued at \$60,084,507, and equity method valued at \$228,133, the values of which were determined in good faith by, or under the direction of, the Board of Directors. As of March 31, 2016, approximately 73 percent of our net assets represent investments in portfolio companies valued by the Board of Directors.

Determining fair value requires that judgment be applied to the specific facts and circumstances of each portfolio investment, although our valuation policy is intended to provide a consistent basis for determining fair value of the portfolio investments. Factors that may be considered include, but are not limited to, 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 March 31, 2016.

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 March 31, 2016, approximately 81 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 used 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 health care 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, 2015, and to calculate our 2016 expense was 4.15 percent. We used a discount rate of 3.08 percent to calculate our pension obligation for the Executive Mandatory Retirement Benefit Plan.

### Recent Developments - Portfolio Companies

On April 7, 2016, the Company made a \$500,000 follow-on investment in NGX Bio, Inc., a privately held portfolio company.

On April 13, 2016, the Company made a \$550,290 follow-on investment in Lodo Therapeutics, Corporation, a privately held portfolio company.

On April 20, 2016, the Company received proceeds of \$390,492 from funds held in escrow relating to the sale of Molecular Imprints, Inc.'s semiconductor lithography equipment business to Canon, Inc.

On April 22, 2016, the Company made a \$225,000 initial investment in Fleet Health Alliance, LLC, a privately held portfolio company.



On May 4, 2016, the Company made a \$150,000 initial investment in AgTech Accelerator Corporation, a privately held portfolio company.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our business activities contain elements of risk. We consider the principal types of market risk to be valuation risk, 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 1. Consolidated Financial Statements.")

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 depreciation on investments." Changes in valuation of any of our investments in privately held companies from one period to another may be volatile.

Investments in privately held, 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 \$474,030 at March 31, 2016.

## **Item 4. Controls and Procedures**

(a) *Disclosure Controls and Procedures.* As of the end of the period covered by this report, the Company's management, under the supervision and with the participation of our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as required by Rules 13a-15 of the 1934 Act). Disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the 1934 Act is recorded, processed, summarized and reported, within time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the issuer's management, as appropriate, to allow timely decisions regarding required disclosures. As of March 31, 2016, based upon this evaluation of our disclosure controls and procedures, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective.

(b) *Changes in Internal Control Over Financial Reporting.* There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the 1934 Act) during the first quarter of 2016 to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1A. Risk Factors**

Investing in our common stock involves significant risks relating to our business and investment objective. You should carefully consider the risks and uncertainties described in our Annual Report on Form 10-K for the year ended December 31, 2015, before you purchase any of our common stock.

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

As of March 31, 2016, we believe that the following updates should be considered to the risk factors previously disclosed in response to “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

**Approximately 56.7 percent of the net asset value attributable to our equity-focused venture capital investment portfolio, or 48.5 percent of our net asset value, as of March 31, 2016, is concentrated in D-Wave Systems, Inc., Metabolon, Inc., Adesto Technologies Corporation, and HZO, Inc.**

At March 31, 2016, we valued our investment in D-Wave, which had a historical cost to us of \$5,689,311, at \$11,539,147, our investment in Metabolon, which had a historical cost to us of \$7,231,212, at \$11,078,071, our investment in Adesto, which had a historical cost to us of \$11,482,417, at \$9,946,658, and our investment in HZO, which had a historical cost to us of \$8,876,508, at \$7,418,321, which collectively represent 56.7 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 48.5 percent of our net asset value.

Any downturn in the business outlook and/or substantial changes in the funding requirements of Adesto, Metabolon, D-Wave or HZO 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.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

**Sales of Unregistered Equity Securities**

We did not engage in unregistered sales of equity securities during the three months ended March 31, 2016.



### Issuer Purchases of Equity Securities

On August 6, 2015, our Board of Directors authorized a repurchase of up to \$2.5 million of the Company's common stock in the open market within a six-month period. Under the repurchase program, we may, but we are not obligated to, repurchase our outstanding common stock in the open market from time to time provided that we comply with the prohibitions under our Insider Trading Policies and Procedures and the guidelines specified in Rule 10b-18 of the Securities Exchange Act of 1934, as amended, including certain price, market volume and timing constraints. In addition, any repurchases are conducted in accordance with the 1940 Act. During the year ended December 31, 2015, we repurchased 509,082 shares at an average price of approximately \$2.36 per share, inclusive of commissions. This represented a discount of approximately 18.1 percent of the net asset value per share at December 31, 2015. The total dollar amount of shares repurchased in this period was \$1,199,994, leaving a maximum of \$1,300,006 available for future program purchases as of December 31, 2015. The six-month period expired on February 6, 2016. On March 3, 2016, our Board of Directors reauthorized the repurchase of up to \$2.5 million of the Company's common stock within a six-month period. As of March 31, 2016, no additional repurchases have occurred, leaving a maximum of \$2.5 million available for future repurchases.

The following table discloses on a monthly basis the total number of shares repurchased (including the total number of shares repurchased under this program), the average price paid per share, and the maximum number of shares (or approximate dollar value) of shares that may yet be repurchased under the program.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Program	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Program
August 21- 31, 2015	88,875	\$ 2.54	88,875	\$ 2,274,557
September 1-30, 2015	209,944	2.44	298,819	1,762,338
October 1-12, 2015	119,365	2.20	418,184	1,500,003
November 30, 2015	11,899	2.22	430,083	1,473,643
December 1-9, 2015	78,999	2.20	509,082	1,300,006

### Item 3. Defaults Upon Senior Securities

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

31.01\* Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.02\* Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32\* Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\*filed herewith

100

## SIGNATURES

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

Harris & Harris Group, Inc.

/s/ Douglas W. Jamison  
By: Douglas W. Jamison  
Chief Executive Officer

/s/ Patricia N. Egan  
By: Patricia N. Egan  
Chief Financial Officer

Date: May 9, 2016

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
31.01	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

102

## Schedule 12-14

## HARRIS &amp; HARRIS GROUP, INC.

## INVESTMENTS IN AND ADVANCES TO AFFILIATES

Name of Issuer	Title of Issue or <b>Nature of Indebtedness<sup>(A)</sup></b>	Amount of Dividends or Interest Credited <b>to Income (B)</b>	Value as of December 31, 2015	Gross Additions (C)	Gross Reductions (D)	Value as of March 31, 2016
<b>MAJORITY OWNED CONTROLLED INVESTMENTS:</b>						
Black Silicon Holdings, Inc.	Series A Convertible Preferred Stock	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
	Series A-1 Convertible Preferred Stock	0	0	0	0	0
	Series A-2 Convertible Preferred Stock	0	0	0	0	0
	Series B-1 Convertible Preferred Stock	0	0	0	0	0
	Series C Convertible Preferred Stock	0	0	0	0	0
	Secured Convertible Bridge Notes	25,853	316,613	5,510	0	322,123
Interome, Inc.	Common Stock	\$ 0	\$ 0	\$ 10	\$ 0	\$ 10
	Secured Convertible Bridge Note	3,100	0	300,000	0	300,000
NGX Bio, Inc.		\$ 0	\$ 446,878	\$ 48,940	\$ 0	\$ 495,818

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

Series Seed Convertible  
Preferred Stock

Series A Convertible Preferred Stock 0 403,538 0 (63,777 ) 339,761

Warrants for Series Seed Preferred Stock 0 148,958 0 (148,958 ) 0

ProMuc, Inc. Common Stock \$ 0 \$ 1 \$ 0 \$ 0 \$ 1

Secured Convertible Bridge Note 11,568 650,915 11,568 0 662,483

SynGlyco, Inc. Common Stock \$ 0 \$ 0 \$ 0 \$ 0 \$ 0

Series A' Convertible Preferred Stock 0 100,343 0 (12,255 ) 88,088

Secured Convertible Bridge Notes 10,243 808,101 0 (739,757 ) 68,344

TARA Biosystems, Inc. Common Stock \$ 0 \$ 20 \$ 0 \$ 0 \$ 20

Secured Convertible Bridge Notes 34,386 2,023,419 39,611 0 2,063,030

Total Majority Owned Controlled Investments \$ 85,150 \$ 4,898,786 \$ 405,639 \$(964,747 ) \$ 4,339,678

Name of Issuer	Title of Issue or <b>Nature of Indebtedness<sup>(A)</sup></b>	Amount of Dividends or Interest Credited <b>to Income (B)</b>	Value as of December 31, 2015	Gross Additions (C)	Gross Reductions (D)	Value as of March 31, 2016
<b>OTHER CONTROLLED INVESTMENTS:</b>						
Senova Systems, Inc.	Series B Convertible Preferred Stock	\$ 0	\$ 284,938	\$ 0	\$(174,581 )	\$ 110,357
	Series B-1 Convertible Preferred Stock	0	659,411	0	(433,800 )	225,611
	Series C Convertible Preferred Stock	0	1,127,419	0	(189,405 )	938,014
	Warrants for Series B Preferred Stock	0	39,980	0	(24,495 )	15,485
	Secured Convertible Bridge Note	5,274	0	255,274	0	255,274
Total Other Controlled Investments		\$ 5,274	\$ 2,111,748	\$ 255,274	\$(822,281 )	\$ 1,544,741
Total Controlled Investments		\$ 90,424	\$ 7,010,534	\$ 660,913	\$(1,787,028)	\$ 5,884,419
<b>AFFILIATED INVESTMENTS:</b>						
ABSMaterials, Inc.	Series A Convertible Preferred Stock	\$ 0	\$ 160,303	\$ 20,681	\$ 0	\$ 180,984
	Series B Convertible Preferred Stock	0	823,319	0	(621 )	822,698
	Secured Convertible Bridge Note	1,578	0	101,578	0	101,578



AgBiome, LLC	Series A-1 Convertible Preferred Stock	\$ 0	\$ 4,022,722	\$ 124,885	\$ 0	\$ 4,147,607
	Series A-2 Convertible Preferred Stock	0	891,588	30,002	0	921,590
	Series B Convertible Preferred Stock	0	575,979	10,341	0	586,320
D-Wave Systems, Inc.	Series 1 Class B Convertible Preferred Stock	\$ 0	\$ 1,485,943	\$ 1,032,366	\$ 0	\$ 2,518,309
	Series 1 Class C Convertible Preferred Stock	0	588,844	407,982	0	996,826
	Series 1 Class D Convertible Preferred Stock	0	1,117,858	774,509	0	1,892,367
	Series 1 Class E Convertible Preferred Stock	0	368,385	239,717	0	608,102

Name of Issuer	Title of Issue or <b>Nature of Indebtedness<sup>(A)</sup></b>	Amount of Dividends or Interest Credited to Income (B)	Value as of December 31, 2015	Gross <b>Additions</b> (C)	Gross <b>Reductions</b> (D)	Value as of March 31, 2016
D-Wave Systems, Inc. (Cont'd)	Series 1 Class F Convertible Preferred Stock	\$ 0	\$ 353,940	\$ 230,317	\$ 0	\$ 584,257
	Series 1 Class H Convertible Preferred Stock	0	732,972	408,648	0	1,141,620
	Series 2 Class D Convertible Preferred Stock	0	886,651	614,317	0	1,500,968
	Series 2 Class E Convertible Preferred Stock	0	711,876	458,894	0	1,170,770
	Series 2 Class F Convertible Preferred Stock	0	683,959	440,898	0	1,124,857
	Warrants for Common Stock	0	710	361	0	1,071
EchoPixel, Inc.	Series Seed Convertible Preferred Stock	\$ 0	\$ 1,327,092	\$ 8,355	\$ 0	\$ 1,335,447
	Convertible Bridge Note	525	113,425	0	(113,425 )	0
	Series Seed-2 Convertible Preferred Stock	0	0	503,612	0	503,612
Ensemble Therapeutics Corporation	Series B Convertible Preferred Stock	\$ 0	\$ 662,607	\$ 42,053	\$ 0	\$ 704,660
	Series B-1 Convertible Preferred Stock	0	1,448,295	0	(7,565 )	1,440,730
HZO, Inc.	Common Stock	\$ 0	\$ 329,802	\$ 30,192	\$ 0	\$ 359,994
	Series I Convertible Preferred Stock	0	4,281,820	204,861	0	4,486,681

	Series II Convertible Preferred Stock	0	2,515,164	56,482	0	2,571,646
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>(E)</sup>	0	0	0	0	0
Lodo Therapeutics Corporation	Series A Convertible Preferred Stock	\$ 0	\$ 107,281	\$ 554	\$ 0	\$ 107,835
Metabolon, Inc.	Series B Convertible Preferred Stock	\$ 0	\$ 3,699,120	\$ 0	\$ (741,622 )	\$ 2,957,498
	Series B-1 Convertible Preferred Stock	0	1,479,647	0	(296,649 )	1,182,998
	Series C Convertible Preferred Stock	0	3,388,907	0	(677,613 )	2,711,294
	Series D Convertible Preferred Stock	0	2,887,617	0	(528,118 )	2,359,499

Name of Issuer	Title of Issue or <b>Nature of Indebtedness<sup>(A)</sup></b>	Amount of Dividends or Interest Credited to Income (B)	Value as of December 31, 2015	Gross <b>Additions</b> (C)	Gross <b>Reductions</b> (D)	Value as of March 31, 2016
Metabolon, Inc. (Cont'd)	Series E-1 Convertible Preferred Stock	\$ 0	\$ 1,776,987	\$ 0	\$(242,592 )	\$ 1,534,395
	Series E-2 Convertible Preferred Stock	0	389,566	0	(57,179 )	332,387
ORIG3N, Inc.	Series I Convertible Preferred Stock	\$ 0	\$ 826,563	\$ 1,059	\$ 0	\$ 827,622
	Series A Convertible Preferred Stock	0	750,338	0	(2,395 )	747,943
Petra Pharma Corporation	Series A Convertible Preferred Stock	\$ 0	\$ 1,019,755	\$ 3,780	\$ 0	\$ 1,023,535
Produced Water Absorbents, Inc.	Series A Convertible Preferred Stock	\$ 0	\$ 77,549	\$ 0	\$(54,426 )	\$ 23,123
	Series B Convertible Preferred Stock	0	214,302	0	(150,402 )	63,900
	Series B-2 Convertible Preferred Stock	0	154,718	0	(108,585 )	46,133
	Series B-3 Convertible Preferred Stock	0	140,109	0	(98,332 )	41,777
	Series C Convertible Preferred Stock	0	75,581	0	(53,045 )	22,536
	Series D Convertible Preferred Stock	0	133,330	0	(93,574 )	39,756
	Warrants for Series B-2 Convertible Preferred Stock	0	174	0	(174 )	0

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

Subordinated Secured Non-Convertible Debt	34,958	560,538	9,953	0	570,491
Secured Convertible Bridge Note	23,630	143,926	0	(23,677 )	120,249
Senior Secured Debt	0	0	875,000	0	875,000
Total Affiliated Private Investments	\$ 60,691	\$ 41,909,262	\$ 6,631,397	\$ (3,249,994 )	\$ 45,290,665

iv

Name of Issuer	Title of Issue or Nature of Indebtedness <sup>(A)</sup>	Amount of Dividends or Interest Credited to Income (B)	Value as of December 31, 2015	Gross Additions (C)	Gross Reductions (D)	Value as of March 31, 2016
<b>PUBLICLY TRADED AFFILIATED INVESTMENTS:</b>						
Adesto Technologies Corporation	Common Stock	\$0	\$13,645,682	\$0	\$(3,699,024)	\$9,946,658
Enumeral Biomedical Holdings, Inc.	Common Stock	\$0	\$1,831,468	\$0	\$(556,849)	\$1,274,619
	Warrants for Common Stock	0	87,486	0	(35,383)	52,103
	Options to Purchase Common Stock	0	54	0	(54)	0
OpGen, Inc.	Common Stock	\$0	\$2,678,612	\$0	\$(690,800)	\$1,987,812
	Warrants for Common Stock	0	127,803	0	(27,195)	100,608
Total Non- Controlled Affiliated Public Investments		\$0	\$18,371,105	\$0	\$(5,009,305)	\$13,361,800
Total Non- Controlled Affiliated Investments		\$60,691	\$60,280,367	\$6,631,397	\$(8,259,299)	\$58,652,465
<b>EQUITY METHOD</b>						

## INVESTMENT:

Accelerator IV-New York Corporation	Series A Common Stock	\$0	\$165,936	\$62,197	\$0	\$228,133
Total Equity Method Investment		\$0	\$165,936	\$62,197	\$0	\$228,133

(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 March 31, 2016, and December 31, 2015.

(B) Represents the total amount of interest or dividends and yield-enhancing fees on debt securities 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 the first quarter of 2016.

(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.

\*\*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, with the exception of Accelerator IV-New York Corporation, which is accounted for under the equity method.