

HARRIS & HARRIS GROUP INC /NY/
Form 10-Q
August 10, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2015

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)

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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 August 10, 2015
Common Stock, \$0.01 par value per share	31,321,685 shares

Harris & Harris Group, Inc.

Form 10-Q, June 30, 2015

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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.[®] (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, 2014.

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

	June 30, 2015	December 31, 2014
<u>ASSETS</u>		
Investments, in portfolio securities at value:		
Unaffiliated privately held companies (cost: \$20,307,754 and \$22,304,047, respectively)	\$7,452,767	\$ 13,854,906
Unaffiliated rights to milestone payments (adjusted cost basis: \$2,387,278 and \$2,387,278, respectively)	3,181,183	3,193,865
Unaffiliated publicly traded securities (cost: \$1,682,079 and \$1,741,128, respectively)	1,561,988	1,398,085
Non-controlled affiliated privately held companies (cost: \$64,678,768 and \$67,236,533, respectively)	58,952,248	58,470,864
Non-controlled affiliated publicly traded companies (cost: \$11,683,371 and \$5,591,299, respectively)	10,695,100	8,384,641
Controlled affiliated privately held companies (cost: \$13,505,442 and \$13,111,030, respectively)	5,207,773	4,462,479
Equity method privately held companies (adjusted cost basis: \$288,391 and \$0, respectively)	288,391	0
Total, investments in private portfolio companies, rights to milestone payments, public securities at value (cost: \$114,533,083 and \$112,371,315, respectively)	\$87,339,450	\$ 89,764,840
Cash	22,982,089	20,748,314
Funds held in escrow from sales of investments at value (Note 3)	372,835	306,802
Receivable from portfolio company	17,500	160,877
Interest receivable	72,826	62,482
Prepaid expenses	554,767	754,856
Other assets	417,265	296,690
Total assets	\$111,756,732	\$ 112,094,861
LIABILITIES & NET ASSETS		
Term loan credit facility (Note 5)	\$5,000,000	\$ 0
Post retirement plan liabilities (Note 8)	1,293,962	1,267,615
Accounts payable and accrued liabilities	674,840	841,915
Deferred rent	305,192	330,904
Total liabilities	\$7,273,994	\$ 2,440,434
Commitments and contingencies (Note 12)		
Net assets	\$104,482,738	\$ 109,654,427

Net assets are comprised of:

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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 6/30/15 and 12/31/14; 33,150,425 and 33,109,583 issued at 6/30/15 and 12/31/14, respectively	331,504	331,096
Additional paid in capital (Note 9)	215,435,591	215,051,662
Accumulated net operating and realized loss	(81,298,904)	(80,434,528)
Accumulated unrealized depreciation of investments	(27,193,633)	(22,606,475)
Accumulated other comprehensive income (Note 8)	613,711	718,203
Treasury stock, at cost (1,828,740 shares at 6/30/15 and 12/31/14)	(3,405,531)	(3,405,531)
Net assets	\$ 104,482,738	\$ 109,654,427
Shares outstanding	31,321,685	31,280,843
Net asset value per outstanding share	\$3.34	\$ 3.51

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 June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Investment income:				
Interest from:				
Unaffiliated companies	\$ 9,533	\$ 36,447	\$ 20,776	\$ 86,682
Non-controlled affiliated companies	201,896	41,095	254,322	83,371
Controlled affiliated companies	47,207	36,607	91,633	71,333
Cash and U.S. Treasury securities and other	3,318	2,929	4,748	6,478
Fees for providing managerial assistance to portfolio companies	6,500	0	13,500	0
Yield-enhancing fees on debt securities	19,741	16,757	46,048	32,262
Total investment income	288,195	133,835	431,027	280,126
Expenses:				
Salaries, benefits and stock-based compensation (Note 9)	977,689	1,247,426	2,056,178	2,659,786
Administration and operations	134,860	206,960	236,094	337,440
Professional fees	314,785	385,352	887,019	597,223
Rent	67,758	80,065	135,464	148,091
Insurance expense	73,724	84,007	141,335	167,940
Directors' fees and expenses	68,901	93,131	188,525	186,408
Interest and other debt expenses	208,026	94,276	351,746	187,996
Custody fees	15,704	14,228	31,616	29,019
Depreciation	12,055	13,245	24,702	26,450
Total expenses	1,873,502	2,218,690	4,052,679	4,340,353
Net operating loss	(1,585,307)	(2,084,855)	(3,621,652)	(4,060,227)
Net realized gain (loss):				
Realized gain (loss) from investments:				
Unaffiliated companies	3,289,351	3,946,838	3,299,836	3,946,838
Non-Controlled affiliated companies	(98,644)	588,221	(392,430)	(6,711,063)
Publicly traded companies	41,411	960,882	41,411	1,333,497
Written call options	0	197,309	0	86,653
Realized gain (loss) from investments	3,232,118	5,693,250	2,948,817	(1,344,075)
Income tax expense (Note 10)	1,600	0	1,705	15,986
Net realized gain (loss) from investments	3,230,518	5,693,250	2,947,112	(1,360,061)

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Net (increase) decrease in unrealized depreciation on investments:				
Investments	(3,116,377)	796,969	(4,587,158)	3,183,622
Written call options	0	(77,309)	0	89,044
Net (increase) decrease in unrealized depreciation on investments	(3,116,377)	719,660	(4,587,158)	3,272,666
Net realized and unrealized gains (loss) on investments	114,141	6,412,910	(1,640,046)	1,912,605
Share of loss on equity method investment	(58,330)	0	(189,836)	0
Net (decrease) increase in net assets resulting from operations:				
Total	\$(1,529,496)	\$4,328,055	\$(5,451,534)	\$(2,147,622)
Per average basic and diluted outstanding share	\$(0.05)	\$0.14	\$(0.17)	\$(0.07)
Average outstanding shares	31,285,894	31,201,574	31,283,382	31,199,518

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 June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net (decrease) increase resulting from operations	\$ (1,529,496)	\$ 4,328,055	\$ (5,451,534)	\$ (2,147,622)
Other comprehensive (loss) income:				
Amortization of prior service cost	(52,246)	(52,246)	(104,492)	(104,492)
Other comprehensive loss	(52,246)	(52,246)	(104,492)	(104,492)
Comprehensive (loss) income	\$ (1,581,742)	\$ 4,275,809	\$ (5,556,026)	\$ (2,252,114)

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

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

	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Cash flows (used in) provided by operating activities:		
Net (decrease) in net assets resulting from operations	\$ (5,451,534	) \$ (2,147,622
Adjustments to reconcile net (decrease) in net assets resulting from operations to net cash provided by (used in) operating activities:		
Net realized loss (gain) and change in unrealized depreciation (appreciation) on investments	1,638,341	(1,928,591
Depreciation of fixed assets, amortization of prepaid assets and accretion of bridge note interest	(279,990	) (140,878
Share of loss on equity method investee	189,836	0
Stock-based compensation expense	431,981	497,634
Amortization of prior service cost	(104,492	) (104,492
Purchase of U.S. government securities	0	(19,999,044
Sale of U.S. government securities	0	38,998,052
Purchase of equity method investment	(262,215	) 0
Purchase of affiliated portfolio companies	(4,275,915	) (9,714,299
Purchase of unaffiliated portfolio companies	(509,824	) (240,500
Payments received on debt investments	186,109	224,711
Proceeds from sale of investments and conversion of bridge notes	5,698,094	9,766,197
Proceeds from call option premiums	0	338,229
Payments for put and call option purchases	0	(218,532
Changes in assets and liabilities:		
Receivable from sales of investments	0	448,886
Receivable from portfolio company	143,377	(325
Interest receivable	(10,344	) 1,202
Prepaid expenses	200,089	240,034
Other assets	(138,848	) (2,209
Post retirement plan liabilities	26,347	32,409
Accounts payable and accrued liabilities	(167,075	) 179,145
Deferred rent	(25,712	) (22,293
Net cash (used in) provided by operating activities	(2,711,775	) 16,207,714
Cash flows from investing activities:		
Purchase of fixed assets	(6,806) (1,066
Net cash used in investing activities	(6,806) (1,066

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Cash flows from financing activities:

Proceeds from drawdown of loan facility	5,000,000	0
Payment of withholdings related to net settlement of restricted stock	(47,644	) (68,872
Net cash provided by (used in) financing activities	4,952,356	(68,872
Net increase in cash	\$ 2,233,775	\$ 16,137,776
Cash at beginning of the period	20,748,314	8,538,548
Cash at end of the period	\$ 22,982,089	\$ 24,676,324
Supplemental disclosures of cash flow information:		
Income taxes paid	\$ 1,705	\$ 15,986

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)**

	Six Months Ended June 30, 2015	Year Ended December 31, 2014
Changes in net assets from operations:		
Net operating loss	\$ (3,621,652	) \$ (7,901,727)
Net realized gain (loss) on investments	2,947,112	(5,083,625)
Net (increase) in unrealized depreciation on investments	(4,587,158	) (576,186)
Net (decrease) in unrealized appreciation on written call options	0	(8,882)
Share of loss on equity method investment	(189,836	) 0
Net decrease in net assets resulting from operations	(5,451,534	) (13,570,420)
Changes in net assets from capital stock transactions:		
Acquisition of vested restricted stock awards to pay required employee withholding tax	(47,644	) (124,751)
Stock-based compensation expense	431,981	857,006
Net increase in net assets resulting from capital stock transactions	384,337	732,255
Changes in net assets from accumulated other comprehensive (loss) income:		
Other comprehensive (loss)	(104,492	) (208,983)
Net (decrease) in net assets resulting from accumulated other comprehensive (loss) income	(104,492	) (208,983)
Net decrease in net assets	(5,171,689	) (13,047,148)
Net Assets:		
Beginning of the period	109,654,427	122,701,575

End of the period	\$ 104,482,738	\$ 109,654,427
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The accompanying unaudited notes are an integral part of these consolidated financial statements.

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HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF JUNE 30, 2015**(Unaudited)**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	<u>Value</u>
Investments in Unaffiliated Companies (3) – 11.7% of net assets at value					
Private Placement Portfolio (Illiquid) (4) – 7.1% 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	(M)		\$1,000,000	1,861,504	\$259,311
Series C Convertible Preferred Stock	(M)		1,352,196	2,130,699	535,508
Series D Convertible Preferred Stock	(M)		1,371,622	999,999	738,068
Series E Convertible Preferred Stock	(M)		672,599	440,334	608,448
Series E-1 Convertible Preferred Stock	(M)		386,073	399,579	401,208
Warrants for Series C Convertible Preferred Stock expiring 8/31/15	(M)		168,270	163,900	0
Warrants for Series D Convertible Preferred Stock expiring 8/31/15	(M)		128,543	166,665	0
Warrants for Series E Convertible Preferred Stock expiring 12/31/17	(M)		93,969	170,823	0
Warrants for Common Stock expiring 6/1/16	(M)		72,668	132,100	0
Warrants for Common Stock expiring 8/9/18	(M)		148,409	171,183	0
Warrants for Common Stock expiring 10/21/18	(M)		18,816	84,846	0
			5,413,165		2,542,543
Cambrios Technologies Corporation (5)(8)(9)					
Developing nanowire-enabled electronic materials for the display industry					
Series B Convertible Preferred Stock	(I)		1,294,025	1,294,025	47,659
Series C Convertible Preferred Stock	(I)		1,300,000	1,300,000	47,879
Series D Convertible Preferred Stock	(I)		515,756	515,756	368,541
Series D-2 Convertible Preferred Stock	(I)		92,400	92,400	33,322
Series D-4 Convertible Preferred Stock	(I)		216,168	216,168	77,955
			3,418,349		575,356
Cobalt Technologies, Inc. (8)(9)(10)(11)					
Energy					

Developed processes for making bio-butanol through biomass fermentation

Series C-1 Convertible Preferred Stock	(M)	749,998	352,112	0
Series D-1 Convertible Preferred Stock	(M)	122,070	48,828	0
Series E-1 Convertible Preferred Stock	(M)	114,938	46,089	0
Warrants for Series E-1 Pref. Stock expiring on 10/9/22	(I)	2,781	1,407	0
Warrants for Series E-1 Pref. Stock expiring on 3/11/23	(I)	5,355	2,707	0
		995,142		0

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF JUNE 30, 2015**(Unaudited)**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) – 11.7% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) – 7.1% of net assets at value (Cont.)					
Magic Leap, Inc. (8)(9)(12) Developing novel human computing interfaces and software		Electronics			
Series B Convertible Preferred Stock	(I)		\$338,604	29,291	\$319,472
Mersana Therapeutics, Inc. (5)(8)(9) Developing antibody drug conjugates for cancer therapy		Life Sciences			
Series A-1 Convertible Preferred Stock	(I)		683,538	635,081	455,263
Series B-1 Convertible Preferred Stock	(I)		104,521	97,111	107,706
Common Stock	(I)		3,875,395	350,539	143,695
			4,663,454		706,664
Nanosys, Inc. (5)(8) Developing inorganic nanowires and quantum dots for use in LED-backlit devices		Energy			
Series C Convertible Preferred Stock	(M)		1,500,000	803,428	491,935
Series D Convertible Preferred Stock	(M)		3,000,003	1,016,950	1,674,974
Series E Convertible Preferred Stock	(M)		496,573	433,688	664,176
			4,996,576		2,831,085
Nano Terra, Inc. (5) Developing surface chemistry and nano- manufacturing solutions		Energy			
Senior secured debt, 12.0%, maturing on 12/1/15	(I)		163,857	\$199,259	198,420
Warrants for Common Stock expiring on 2/22/21	(I)		69,168	4,462	1,365

Warrants for Series A-3 Pref. Stock expiring on 11/15/22	(I)	35,403	47,508	63,826
		268,428		263,611

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

HARRIS & HARRIS GROUP, INC.

CONSOLIDATED SCHEDULE OF INVESTMENTS AS OF JUNE 30, 2015**(Unaudited)**

	Method of Valuation (1)	Primary Industry (2)	Cost	Shares/ Principal	Value
Investments in Unaffiliated Companies (3) –					
11.7% of net assets at value (Cont.)					
Private Placement Portfolio (Illiquid) (4) –					
7.1% of net assets at value (Cont.)					
Phylagen, Inc. (5)(8)(13) Developing technology to improve human health and productivity		Life Sciences			
Secured Convertible Bridge Note, 5%, acquired 2/5/15	(M)		\$204,000	\$200,000	\$204,000
Secured Convertible Bridge Note, 5%, acquired 6/5/15	(M)		10,036	\$10,000	10,036
			214,036		214,036
Total Unaffiliated Private Placement Portfolio (cost: \$20,307,754)					\$7,452,767
Rights to Milestone Payments (Illiquid) (6) – 3.1% of net assets at value					
Amgen, Inc. (8)(9) Rights to Milestone Payments from Acquisition of BioVex Group, Inc.		Life Sciences			
	(I)		\$1,757,608	\$1,757,608	\$2,549,261
Laird Technologies, Inc. (8)(9) Rights to Milestone Payments from Merger & Acquisition of Nextreme Thermal Solutions, Inc.		Energy			