

HARRIS & HARRIS GROUP, INC.®

*Venture Capital for Tiny Technology*

**THIRD QUARTER REPORT 2006**

**FELLOW SHAREHOLDERS:**

In the third quarter ended September 30, 2006, there were only eight initial public offerings (IPOs) of venture capital-backed companies in the United States, as compared with 19 in the third quarter of 2005. In the third quarter of 2004, there had been 24 such IPOs, the most in any quarter since the third quarter of 2000. Prior to the stock market bust of 2000, it was not uncommon to see 50 to 75 venture capital-backed IPOs per quarter.

In our Letter to Shareholders in the 2005 Annual Report, we wrote: "At this writing, although the year is of course still young, the current market for venture-backed initial public offerings (IPOs) is lackluster. We are not aware at this writing of any potential blockbuster nanotechnology IPOs, either from our portfolio or elsewhere, that are being scheduled for 2006. Meanwhile, in the real world of commercial development, the wheat is being winnowed from the chaff. Could 2007 be a different IPO story, as the nanotechnology-enabled companies that are emerging as commercially viable continue to progress and mature? As always, much will depend on the conditions in the capital markets."

Of course, capital markets' conditions often change without notice. But, unless the receptivity of the capital markets to venture capital-backed IPOs improves significantly, we would not be surprised if none of our portfolio companies were to file for an IPO in 2007. Sales of portfolio companies in mergers and acquisitions (M&A) transactions are less predictable, as they are often initiated by third parties. And, of course, other exit strategies do exist, such as going public on foreign stock exchanges, reverse mergers into public shells and selling to special purpose acquisition companies (SPACs).

Some argue that the slowdown in venture-backed IPOs is secular; some argue that it is merely cyclical. We think that there is merit in both arguments. The secular case cites such new phenomena as the costs and administrative burdens of Sarbanes-Oxley compliance, growing risk aversion on the part of institutions, the demand by institutions as they have gotten larger for larger capitalization issues and the need for larger deals on the part of investment bankers as they too have gotten larger. The cyclical case rests on history: there have been, for a variety of reasons, many IPO droughts of varying duration, and eventually the floodgates have always reopened.

Since the mid-term elections, discussion in Washington has intensified about the discouraging effect that Sarbanes-Oxley has had on IPOs of foreign companies in the U.S. and on IPOs of smaller domestic companies. Christopher Cox, the chairman of the Securities and Exchange Commission, has recently proposed steps that would be intended to reduce the audit costs for smaller public companies associated with complying with Section 404 of Sarbanes-Oxley; and, according to the *Financial Times*, Barney Frank, the likely new chairman of the House of Representatives' financial services committee, has been quoted as saying that Section 404 is "too burdensome," and Mr. Frank has indicated that his committee will make changes within the next eight months.

Since we began our focus on tiny technology in 2001, we have had money to invest, so we have been able to take advantage of the relative buyer's market that the IPO drought has fostered. But now that some of our companies are becoming more mature, a continuing lack of IPO opportunities could lead to companies staying longer in our portfolio as private entities still requiring funding. In the best case, such stagnation would dampen returns, and in the worst case, could lead to write-downs and write-offs as some companies ran short of cash and had to accept lower valuations in private fundings or were not able to access additional capital at all.

Meanwhile, there is significant commercial progress in our portfolio. Below, please find a table showing our portfolio companies' announced Products Released/Available for Purchase, and their Products in Development. The variety of products illustrates how we naturally achieve product diversification in our portfolio by making tiny technology the common denominator of our investment strategy.

<b>Tiny Technology Companies in H&amp;H portfolio as of 9-30-06</b>	<b>Products Released / Available for Purchase</b>	<b>Products in Development</b>
BridgeLux, Inc. (formerly eLite Optoelectronics, Inc.)	Blue and Green HB-LEDs	Additional colors and types of HB-LEDs
Cambrios, Inc.		Transparent conductors
Chlorogen, Inc.		Plant-made drugs and vaccines
Crystal IS, Inc.	Aluminum Nitride Substrates	High-performance UV Devices
CSwitch, Inc.		High-bandwidth Configurable Switches
D-Wave Systems, Inc.		High-speed analog / quantum computing
Evolved Nanomaterial Sciences, Inc.	Normal phase analytical column and solid phase extraction cartridges for chiral separations	Normal, reversed, and polar organic phase analytical, semi-preparative and preparative columns. Additional products for resolving and preparing chiral molecules
Innovalight, Inc.		Thin-film solar cells
Kereos, Inc.		Emulsion-based targeted therapeutics and molecular imaging agents
Kovio, Inc.		Semiconductor products using printed electronics
Mersana Therapeutics, Inc. (formerly Nanopharma Corporation)		Oncology-focused therapeutic products

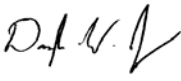
<b>Tiny Technology Companies in H&amp;H portfolio as of 9-30-06</b>	<b>Products Released / Available for Purchase</b>	<b>Products in Development</b>
Metabolon, Inc.	Metabolomics profiling services, Mselect and MProve Clinical	Biomarker discovery and diagnostic tools
Molecular Imprints, Inc.	Tools for nanoimprint lithography	Production scale tools for nanoimprint lithography
NanoGram Corporation	Tools and service business for discovery and production of nanoparticles	Application specific nanoparticles
Nanomix, Inc.	Carbon-nanotube based hydrogen sensors	Carbon-nanotube based sensors for breath analysis and biodetection
NanoOpto Corporation	Optical components such as high-extinction IR cut filters, polarizers, and optical isolators	Additional optical components
Nanosys, Inc.		Flexible electronic devices, non-volatile memory, consumables for life sciences and fuel cells
Nantero, Inc.		Carbon-nanotube based non-volatile memory
NeoPhotonics Corporation 2004	Active and passive optical components for optical networking	Additional products for optical networking
Nextreme Thermal Solutions, Inc.		Thermoelectric devices for thermal management of integrated circuits and for power generation
Polatis, Inc. (formerly Continuum Photonics, Inc.)	Microelectromechanical-enabled optical switches	Additional optical switching products
Questech Corporation (formerly Intaglio, Ltd.)	Decorative tiles made of stone and microscale-metal materials	
SiOnyx, Inc.		Optical detectors for detection and imaging of visible and infrared light
Solazyme, Inc.		Algae-produced products including nutraceuticals, industrial chemicals and energy
Starfire Systems, Inc.	Ceramic brake rotors and pads and silicon-carbide polymers	Ceramic-based parts for applications in electronics, aerospace and automotive industries
Zia Laser, Inc.		Quantum-dot based lasers for optical clocking

Not so long ago, very few of our portfolio companies had Products Released/Available for Purchase!

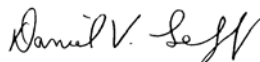
As always, we appreciate our fellow shareholders' support as we continue to take advantage of our robust deal flow to build our portfolio of tiny-technology investments, particularly in companies working at the nanoscale. Early-stage venture capital investing, particularly in novel technologies, requires the sort of patience that our shareholders have long demonstrated.



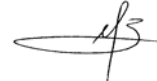
Charles E. Harris  
Chairman and Chief Executive Officer  
Managing Director



Douglas W. Jamison  
President and Chief Operating Officer  
Managing Director



Daniel V. Leff  
Executive Vice President  
Managing Director



Alexei A. Andreev  
Executive Vice President  
Managing Director

November 16, 2006

This letter may contain statements of a forward-looking nature relating to future events. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. These statements reflect the Company's current beliefs, and a number of important factors could cause actual results to differ materially from those expressed in this letter. Please see the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, and the Company's report on Form 10-Q for the quarter ended September 30, 2006, filed with the Securities and Exchange Commission, for a more detailed discussion of the risks and uncertainties associated with the Company's business, including but not limited to the risks and uncertainties associated with venture capital investing and other significant factors that could affect the Company's actual results. Except as otherwise required by Federal securities laws, Harris & Harris Group, Inc.<sup>®</sup>, undertakes no obligation to update or revise these forward-looking statements to reflect new events or uncertainties. The references to portfolio company websites have been provided as a convenience, and the information contained on such websites is not incorporated by reference into this letter.

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

**ASSETS**

	<b>September 30, 2006</b> (Unaudited)	<b>December 31, 2005</b>
Cash, U.S. government and government agency securities and cash equivalents .....	\$ 63,390,164	\$ 97,464,153
Investments, at value .....	52,513,347	33,187,333
Restricted funds .....	2,013,240	1,730,434
Receivable from portfolio company .....	0	75,000
Interest receivable .....	565,762	248,563
Prepaid expenses .....	141,251	2,993
Other assets .....	351,299	229,644
<b>Total assets</b> .....	<u>\$ 118,975,063</u>	<u>\$ 132,938,120</u>

**LIABILITIES & NET ASSETS**

Accounts payable and accrued liabilities .....	\$ 3,443,164	\$ 3,174,183
Accrued profit sharing .....	262,331	2,107,858
Deferred rent .....	23,027	31,003
Current taxes payable .....	198,198	1,514,967
Taxes payable on behalf of shareholders .....	0	8,122,367
<b>Total liabilities</b> .....	<u>3,926,720</u>	<u>14,950,378</u>
<b>Net assets</b> .....	<u>\$ 115,048,343</u>	<u>\$ 117,987,742</u>
<b>Net assets are comprised of:</b>		
Preferred stock, \$0.10 par value, 2,000,000 shares authorized; none issued .....	\$ 0	\$ 0
Common stock, \$0.01 par value, 45,000,000 shares authorized at 9/30/06 and 30,000,000 at 12/31/05; 22,585,085 issued at 9/30/06 and 12/31/05 .....	225,851	225,851
Additional paid in capital .....	124,735,322	122,149,642
Accumulated net realized (loss) income .....	(601,402)	3,781,905
Accumulated unrealized depreciation of investments .....	(5,905,897)	(4,764,125)
Treasury stock, at cost (1,828,740 shares at 9/30/06 and 12/31/05) .....	(3,405,531)	(3,405,531)
<b>Net assets</b> .....	<u>\$ 115,048,343</u>	<u>\$ 117,987,742</u>
<b>Shares outstanding</b> .....	<u>20,756,345</u>	<u>20,756,345</u>
<b>Net asset value per outstanding share</b> .....	<u>\$ 5.54</u>	<u>\$ 5.68</u>

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

	<b>Three Months Ended Sept. 30</b>		<b>Nine Months Ended Sept. 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Investment income:</b>				
Interest from:				
Fixed-income securities .....	\$ 719,619	\$ 315,089	\$ 2,302,246	\$ 743,571
Portfolio companies .....	0	0	0	(9,780)
Miscellaneous income .....	0	285	7,500	5,409
<b>Total investment income</b> .....	<u>719,619</u>	<u>315,374</u>	<u>2,309,746</u>	<u>739,200</u>
<b>Expenses:</b>				
Salaries, benefits and stock-based Compensation .....	3,151,338	673,064	4,741,850	1,855,365
Administration and operations .....	242,930	264,130	971,471	1,076,335
Profit-sharing provision .....	51,545	2,393,488	51,545	4,094,359
Professional fees .....	95,742	124,767	483,567	615,355
Rent .....	59,310	51,996	177,929	151,857
Directors' fees and expenses .....	85,287	64,089	266,089	204,830
Depreciation .....	16,201	17,637	49,097	49,535
Custodian fees .....	6,056	0	18,618	8,599
<b>Total expenses</b> .....	<u>3,708,409</u>	<u>3,589,171</u>	<u>6,760,166</u>	<u>8,056,235</u>
<b>Net operating loss</b> .....	<u>(2,988,790)</u>	<u>(3,273,797)</u>	<u>(4,450,420)</u>	<u>(7,317,035)</u>
<b>Net realized gain (loss) from investments:</b>				
Realized gain (loss) from investments .....	6,420	(240)	19,873	(2,427,469)
Income tax (benefit) expense .....	(242,352)	(13)	(222,815)	4,839
<b>Net realized gain (loss) from investments</b> .....	<u>248,772</u>	<u>(227)</u>	<u>242,688</u>	<u>(2,432,308)</u>
<b>Net (increase) decrease in unrealized depreciation on investments:</b>				
Change as a result of investment sales .....	0	0	0	2,956,491
Change on investments held .....	151,926	10,610,947	(1,317,347)	18,898,178
<b>Net decrease (increase) in unrealized depreciation on investments</b> .....	<u>151,926</u>	<u>10,610,947</u>	<u>(1,317,347)</u>	<u>21,854,669</u>
<b>Net realized and unrealized gain (loss) from investments</b> .....	<u>400,698</u>	<u>10,610,720</u>	<u>(1,074,659)</u>	<u>19,422,361</u>
<b>Net (decrease) increase in net assets resulting from operations:</b>				
<b>Total</b> .....	<u>\$ (2,588,092)</u>	<u>\$ 7,336,923</u>	<u>\$ (5,525,079)</u>	<u>\$ 12,105,326</u>
<b>Per average basic and diluted outstanding share</b> .....	<u>\$ (0.12)</u>	<u>\$ 0.40</u>	<u>\$ (0.27)</u>	<u>\$ 0.68</u>
<b>Average outstanding shares</b> .....	<u>20,756,345</u>	<u>18,593,166</u>	<u>20,756,345</u>	<u>17,701,876</u>

\*Selected quarterly financial information. The information contained herein does not include the full unaudited quarterly financial information. Please see the Company's report on Form 10-Q for the quarter ended September 30, 2006 for the unaudited financial information and notes thereto.

**Portfolio Company Websites**

<u>Portfolio Company</u>	<u>Website Address</u>
AlphaSimplex Group, LLC	www.alphasimplex.com
BridgeLux, Inc.	www.bridgelux.com
Cambrios Technologies Corporation	www.cambrios.com
Chlorogen, Inc.	www.chlorogen.com
Crystal IS, Inc.	www.crystal-is.com
CSwitch, Inc.	www.cswitch.com
D-Wave Systems, Inc.	www.dwavesys.com
Evolved Nanomaterial Sciences, Inc.	www.ensbio.com
Innovalight, Inc.	www.innovalight.com
Kereos, Inc.	www.kereos.com
Kovio, Inc.	www.kovio.com
Mersana Therapeutics, Inc.	www.mersana.com
Metabolon, Inc.	www.metabolon.com
Molecular Imprints, Inc.	www.molecularimprints.com
NanoGram Corporation	www.nanogram.com
Nanomix, Inc.	www.nano.com
NanoOpto Corporation	www.nanoopto.com
Nanosys, Inc.	www.nanosysinc.com
Nantero, Inc.	www.nantero.com
NeoPhotonics Corporation	www.neophotonics.com
Nextreme Thermal Solutions, Inc.	www.nextremethermal.com
Polatis, Inc.	www.polatis.com
Questech Corporation	www.questechmetals.com
SiOnyx, Inc.	www.sionyxinc.com
Solazyme, Inc.	www.solazyme.com
Starfire Systems, Inc.	www.starfiresystems.com
Zia Laser, Inc.	www.zialaser.com

**Venture Capital Investments at September 30, 2006\***

**Investments, at Value**

<b>Tiny Technology</b>	<b>\$52,509,289</b>	<b>99.9%</b>
BridgeLux, Inc.	1,000,000	
Cambrios, Inc.	1,294,025	
Chlorogen, Inc.	1,260,781	
Crystal IS, Inc.	1,319,719	
CSwitch, Inc.	3,350,000	
D-Wave Systems, Inc.	1,793,562	
Evolved Nanomaterial Sciences, Inc.	2,800,000	
Innovalight, Inc.	2,500,000	
Kereos, Inc.	960,000	
Kovio, Inc.	3,000,000	
Mersana Therapeutics, Inc.	1,369,904	
Metabolon, Inc.	2,500,000	
Molecular Imprints, Inc.	4,500,000	
NanoGram Corporation	2,598,693	
Nanomix, Inc.	2,500,000	
NanoOpto Corporation	2,418,204	
Nanosys, Inc.	5,370,116	
Nantero, Inc.	2,246,409	
NeoPhotonics Corporation	5,456,599	
Nextreme Thermal Solutions, Inc.	1,000,000	
Polatis, Inc.	190,680	
Questech Corporation	985,147	
SiOnyx, Inc.	960,050	
Solazyme, Inc.	385,400	
Starfire Systems, Inc.	750,000	
Zia Laser, Inc.	0	
<b>Non-Tiny Technology</b>	<b>\$4,058</b>	<b>.1%</b>
AlphaSimplex Group LLC	\$4,058	
Exponential Business Development Company	0	
<b>Total*</b>	<b>\$52,513,347</b>	<b>100.0%</b>