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Dear Shareholders, Friends of Needham and Prospective Shareholders,

We are pleased to report results for the fourth quarter and for the year 2013 for the Needham Growth Fund, Needham Aggressive Growth Fund and Needham Small-Cap Growth Fund.

Needham Funds' Fourth Quarter and Full Year 2013 Overview

The equity markets were strong in the fourth quarter and in 2013. In the fourth quarter, the Needham Growth Fund (NEEGX) was up 7.7%, the Needham Aggressive Growth Fund (NEAGX) was up 6.1%, and the Needham Small-Cap Growth Fund (NESGX) was up 4.7%. The S&P 500 Total Return Index was up 10.5%, the NASDAQ Composite was up 11.1%, and the Russell 2000 Total Return Index was up 8.7%. The Funds were hurt by their short exposure in the fourth quarter.

In 2013, NEEGX was up 34.7%, NEAGX was up 36.3%, and NESGX was up 27.9%. The S&P 500 Total Return Index was up 32.4%, the NASDAQ was up 40.2%, and the Russell 2000 Index was up 38.8%. The year was dominated by the accommodative monetary policies around the world, with a pause in August over concern that the Federal Reserve would begin to taper its quantitative easing program. The Funds outperformed in May and July with strong earnings and merger and acquisition activity.

We highlight Super Micro Computer, Inc. (SMCI), up 27% in the fourth quarter and 68% in 2013, and held by all three Funds. The company makes servers and storage systems. CEO Charles Liang started Super Micro over 20 years ago without venture capital backing and still owns 16% of the company, now valued at about $150 million.

We saw merger and acquisition activity in the fourth quarter and throughout 2013. In December, NESGX and NEAGX holding Solta Medical, Inc. (SLTM) announced an agreement to sell to Valeant Pharmaceuticals International, Inc. (VRX). In November, Anaren (ANEN), held by all three Funds, agreed to be acquired by a financial buyer. In October, MAKO Surgical Corp. (MAKO) agreed to be acquired by Stryker Corp. (SYK), and in December, NEAGX holding AZ Electronic Materials (AZEM; London) agreed to be acquired by Merck KGaA.

We believe the M&A thesis will continue in 2014 and will require patient investing. The Funds benefitted from six other acquisitions in 2013. In 2014, we have already had an additional acquisition of one of the companies held by NEAGX and NESGX as of December 31, 2013. Our small cap companies with innovative products are attractive targets for larger companies with broader distribution.

As 2013 progressed, the pockets of exuberance in the equity markets expanded. From high-flying IPOs, such as Potbelly Corp. (PBPB), FireEye (FEYE) and RocketFuel (FUEL), which were all up 100% on the first day of trading, we saw activity that is not sustainable. Last quarter, we commented that corners of the equities market were seeing extraordinary valuations. Twitter (TWTR) at 26x enterprise value-to-revenues, ServiceNow (NOW) at 13x, and Workday (WDAY) at 22x leave little room for error.

Recently, Facebook agreed to pay $19 billion for WhatsApp with its $20 million of revenue. The valuation was justified as "it's only $40 per user." Billion-dollar private company valuations are common.

Last week, our holding Akamai Technologies priced a four-year convertible bond at a 50% conversion premium and a 0% interest rate. In this era of low and managed interest rates, investment hurdle rates are low and some valuations are extended.

In *The Growth Factor*, we wrote, "Are we in a bubble? We say no, but be careful out there." We believe we are closer to the day when these valuations will end. But in the fourth quarter and in 2013, our shorts were some of the largest detractors.

In other issues of *The Growth Factor,* we wrote about our investment process and our success with three-to –ten-baggers. We also highlighted World Wrestling Entertainment, Inc. (WWE), Clean Harbors, Inc. (CLH), Black Diamond, Inc. (BDE) and several interesting private companies in a preview of the 16th Annual Needham Growth Conference held in January.

2014: Another Year for TINA (There Is No Alternative to Equities)

We continue to believe in TINA, "There Is No Alternative" to equities. Actual monetary tightening seems unlikely. Throughout the developed world, central bankers are pursuing accommodative monetary policies. New Federal Reserve Chairwoman Janet Yellen is focused on employment (not the unemployment rate) and sees need for continued monetary easing. Last month, Christine Lagarde, head of the IMF, warned that deflation must be "fought decisively." In 2012, European Central Bank President Draghi stated an intent to "do whatever it takes" to preserve the Euro and this intent continued for 2013. Japan's Prime Minister Abe and Japan Central Bank President Kuroda have made their marks through depreciating the yen and use of quantitative easing and other monetary tools.

Bonds and pure dividend-paying stocks were poor performers since interest rates bottomed on April 30 of last year. From April 30 thru December 31, 2013, dividend-paying stocks as represented by the Dow Jones Utility Index are down over (6.0)% and the iShares 20+ year Treasury bond ETF is down over (15.2)%, while the Needham Growth Fund was up 22.1%, the Needham Aggressive Growth Fund was up 28.5%, and the Needham Small Cap Growth Fund was up 25.0%.

In the last few months, the correlation between stocks has decreased and the importance of stock selection has increased. We see several themes in our domestic-based holdings, all revolving around applying innovative technology to:

1) Industrial manufacturing, including next-generation semiconductors;

2) Business services thru software-as-a-service and cloud-based technology; and

3) Bring savings and innovation to the healthcare system.

We see opportunity in our valuation-sensitive, domestically focused portfolios in 2014. The best of these investments have become three-to-ten-baggers as they grow and generate long-term capital appreciation. In *Growth Factor #11* we highlighted the 18 three, five and ten-baggers which the Funds have held for three to ten years. During 2013, the Funds had a net addition of one ten-bagger and five five-baggers, and a decrease of two three-baggers. We target the compounding returns that come from sound company management and internally funded growth opportunities, however, our investments may not meet these stated objectives and goals and may lose money.

Over the last three years, the Needham Growth Fund and Needham Aggressive Growth Fund have increased their market capitalizations as their holdings have appreciated. Since March 30, 2010, the large cap exposure of NEEGX has increased to 52% from 21% of its invested net assets, and NEAGX has gone to 29% from 9%. NEAGX also has 10% of assets in mid-cap equities. Our larger cap investments could help dampen volatility in 2014.

We'd like to highlight II-VI Incorporated (IIVI), KVH Industries, Inc. (KVHI), The Street, Inc. (TST), World Wrestling Entertainment and Zygo Corporation (ZIGO) as stocks to watch for 2014. These are all small cap stocks that we believe to be underfollowed and unloved today. II-VI and Zygo fit into our theme of automating industrial manufacturing. The Street (a digital financial media company), KVH Industries (voice and media for the commercial maritime market) and World Wrestling Entertainment (live action sports) are using technology to provide content in new ways.

As the markets have already exhibited in January, we believe 2014 could be a more volatile year, and our ability to short and hold cash could reduce the impact of this market volatility on the Funds. The Funds can hold up to 25% of their net asset value in short positions. Over the last four years, short positions have ranged from 0% to 10% of invested assets, which is where they stood at year-end for all three Funds.

Needham Growth Fund

The Needham Growth Fund was up 7.7% in the fourth quarter and 34.7% for 2013. It was the quarter and year of healthcare. The top three holdings—Express Scripts Holding Company (ESRX), +14%; Thermo Fisher Scientific Inc. (TMO), +21%; and Gilead Sciences, Inc. (GILD), +19%—were the top 3 contributors in the fourth quarter and are all long-term holdings. In 2013, Gilead was +104% and Thermo Fisher +76%.

Over the next few years, we see Gilead with the potential to double the size of its business through its Hepatitis C drug, Sovaldi. Thermo Fisher Scientific, which provides analytical instruments and laboratory technology to the life sciences industry, could see significant synergies from its just completed acquisition of Life Technologies Corporation (LIFE), a leading supplier of DNA reagents, assays and other consumables and instruments to biotechnology companies. Express Scripts, a pharmacy benefits manager, continues to benefit because it reduces the cost of delivering medications.

The biggest percentage winner for 2013 was WageWorks (WAGE), + 234%. WageWorks provides consumer direct benefits management for enterprises. WageWorks saw progress with large enterprise sales, and we believe investors came to recognize the recurring nature of its revenues.

The leading detractors for the year were two short positions. For the year, many of our long-term holdings such as Express Scripts, CarMax, Inc. (KMX), Akamai Technologies, Inc. (AKAM), and Schlumberger NV (SLB) were only +15-30%, which means they underperformed the indices and were a drag on performance. It was that kind of year.

The Needham Growth Fund closed 2013 with holdings of 52% large-cap and 38% small and micro-cap. The fund is not a typical, mid-cap, large-cap or all-cap fund trying to overweight or underweight positions in an index. While Morningstar categorizes the fund as Mid-Cap Growth and Lipper as Mid-Cap Core, we view our mandate to make money through long-term holdings with as little risk as possible. Express Scripts, Thermo Fisher and Gilead are 3-10-year holdings. As of December 31, they were three and five-baggers for the Fund.

The Needham Growth Fund closed the year with a 4% short position and 4% cash, as a percentage of total investments.

Needham Aggressive Growth Fund

The Needham Aggressive Growth Fund was up 6.1% in the fourth quarter and +36.3% for 2013. The top contributor for the quarter and the year was the Fund's largest, long-term holding, PDF Solutions, Inc. (PDFS). PDF was up 21% for the fourth quarter and up 86% in 2013. We believe PDF is at the beginning of an increase in revenue from 28nm production by its leading customers, Samsung and Global Foundries. PDF is still followed by just one Wall Street analyst.

Gilead Sciences was the second best contributor for the quarter and the year. For the quarter, other top contributors were Apple Inc. (AAPL), Electronics for Imaging, Inc. (EFII) Super Micro, and World Wrestling Entertainment, Inc., which was a new holding in the third quarter.

WWE has transitioned from risqué to family entertainment in a world starved for content and sports programming. The just announced WWE Network, which is an over-the-top subscription offering, and the renegotiation of the WWE's TV rights could double or triple earnings over the next few years.

Two of the Fund's largest detractors in the quarter and in 2013 were short positions. One of those positions is a technology equipment provider valued at 10x enterprise value to last 12 months revenue. Historically, companies in this segment are worth 1-2x. We believe the company will have inventory issues at some point in 2014 and we will be rewarded.

In addition to II-VI, KVH Industries, The Street, WWE, and Zygo, we are excited about our underfollowed, small cap investments in CEVA, Inc. (CEVA) and Crawford & Company Class A shares (CRD/A). Except for II-VI, these are all new positions added in 2013. The companies have very little analyst coverage. We'd be glad to follow-up with you on any of these companies.

The Needham Aggressive Growth Fund closed the year with 10% short position and 1% cash.

Needham Small-Cap Growth Fund

The Needham Small Cap Growth Fund was up 4.7% in the fourth quarter and up 27.9% in 2013. Activist involvement in long-term NESGX holding Emulex Corporation (ELX) resulted in the recapitalization of the company and disappointed many investors who had entered the investment in expectation of a terminal transaction. We remain committed to our investment in Emulex, as we believe long-term investors will be rewarded for their patience. The company continues to remove cost and is realigning priorities to higher margin businesses. Emulex is expected to continue its share buyback plan and has at least $100 million still remaining in the announced program. The reduction in share count alone will drive significant growth in the earnings per share, but it will take time for this result to be achieved.

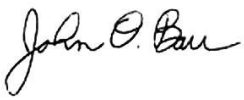
Form Factor, Inc. (FORM), another long-term holding of the Fund, was set to have a good end of year but was negatively impacted by a factory fire at its large customer SK Hynix in China. A product quality issue that had to be fixed and accounted for also impacted FORM. With both of these issues behind the company in 2014, we believe again that patience will pay off and our opportunistic purchases during the fourth quarter will pay off.

Acquisition activity contributed positively to the Fund as two of our holdings, Anaren, Inc. and Solta Medical, Inc., announced intentions to be acquired. We are sorry to see Anaren leave the public markets, as it has been a long-term holding and is an example of a great management team that we seek in our investment process. We believe our other concentrated top positions in Electro Scientific Industries, Inc. (ESIO), TTM Technologies, Inc. (TTMI), II-VI Inc. and Super Micro Computer are all well positioned for 2014.

Closing

We see opportunity in our strategy of investing in companies that we know well and that we believe are positioned with secular growth drivers. We believe 2014 will be another good year for TINA and equities. However, we believe 2014 could bring more volatility to the markets and that our ability to short could dampen the possible volatility. We welcome our new investors and thank all of our investors for their continued support. If you have any questions, thoughts or concerns, please contact us at (800) 625-7071 or send us an email at cretzler@needhamco.com or jbarr@needhamco.com. For information about the funds, please visit our website at www.needhamfunds.com.

Sincerely,



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