

July 2008

Dear Shareholders, Friends of Needham, and Prospective Shareholders:

We are pleased to report in Exhibit A (attached) the performance results for the Needham Small Cap Growth Fund (“NSCGF,” or the “Fund”), NASDAQ symbol NESGX, for the quarter ended June 30, 2008 (“2Q08”), the 12 months ended June 30, 2008 (“1 Year”), the three-year period ended June 30, 2008 (“3 Years”), the five-year period ended June 30, 2008 (“5 Years”), and from May 22, 2002 to June 30, 2008 (“Since Inception”). The Fund was up 2.73% for 2Q08, down 10.12% for the 1 Year, up 2.57% for the 3 Years, up 8.44% for the 5 Years, and up 11.55% Since Inception, compounded annually.

Investment returns and principal value will fluctuate, and when redeemed, shares may be worth more or less than their original cost. Shares held less than 60 days are subject to a short-term redemption fee of 2%. The results contained in this report represent past performance of the Fund. Past performance does not guarantee future results and current performance may be higher or lower than these results. Current month-end performance is available at www.needhamfunds.com.

Investment Strategy

The Fund seeks long-term, tax-efficient capital appreciation by investing primarily in equity securities of smaller growth companies that the Fund believes are trading at a discount to their underlying value yet have the potential for superior long-term growth. Under normal conditions, the Fund invests at least 80% of its net assets in equity securities of domestic issuers that have market capitalizations not exceeding \$2 billion or the highest market capitalization in the Russell 2000[®] Index, if greater, and that are listed on a nationally recognized securities exchange or traded on the NASDAQ System. The highest market capitalization in the Russell 2000[®] Index as of June 30 was \$3.881 billion. Central to the Fund’s investment strategy is a sound valuation discipline that seeks to acquire growth companies at reasonable prices. The Fund seeks tax efficiency by offsetting capital gains on the sale of securities with capital losses, but where there is an uncovered gain, it will be a long-term capital gain taxed at more favorable rates.

Investment Profile

As of June 30, 2008, NSCGF’s sector holdings consisted of the following:

Sector	Long ⁽¹⁾	(Short) ⁽¹⁾	Total ⁽¹⁾⁽²⁾
Healthcare	7.3%	–	7.3%
Energy	–	–	–
Industrial	4.3%	–	4.3%
Financial Services	–	–	–
Business Services	3.3%	–	3.3%
Consumer	1.4%	–	1.4%
Technology	51.3%	–	51.3%
Telecommunications/Cable	12.9%	–	12.9%
Cash	19.5%	–	19.5%
			100.0%

(1) Based on percentage of total investments as of 6/30/08, which includes all stocks plus cash minus all short positions.

(2) Total represents the difference between the long exposure and the short exposure, which produces the net exposure.

NSCGF's top ten holdings at June 30 (in descending order of market value) were Hutchinson Technology, Brooks Automation, Inc., ICx Technologies, Inc., iRobot Corp., Tessa Technologies, Tomotherapy, Inc., Super Micro Computer, Parametric Technology Corp., Airvana, Inc. and Electro Scientific Industries, Inc. The top ten holdings represented 37.87% of total investments versus 49.51% on March 31, 2008. Please note that these portfolio holdings may not be indicative of future portfolio holdings and may change at any time. At the end of the second quarter, the market value of stocks sold short represented 0.00% of the total investments held by NSCGF.

Investment Analysis

The first half of 2008 proved to be a tough and volatile market with significant uncertainty surrounding the depth and length of the financial and housing crisis and its impact on the global economy. The strength of many U.S. financial pillars was challenged and they continue to be tested with regard to their viability. That said, NESGX on both a year to date and quarterly basis outperformed major market indices and its peers. The Fund was well positioned with regard to the downturn in the financial sector and limited direct exposure to the weakening consumer. We took advantage of market rallies during the quarter and exited fair valued positions to prepare against any further slowdown in earnings growth rates and overly optimistic earning expectations.

Soundbite Communications (SDBT) is one of the most exciting new names in the Fund. The company develops and markets automated voice messaging solutions over existing telephony networks. It offers its services to initiate and manage customer contact campaigns for various collections, customer care and marketing processes through a multi-tenant customer communications platform. The company's solutions are used in collection agencies, financial services, telecommunications, utilities and retail industries. We were able to build a position following disappointing company news and a reactionary market. We have recently met with the management of SDBT and are confident in their long-term strategy.

Another relatively new name to the Fund is Netezza (NZ). The position was a strong contributor during the second quarter and the company continues to execute on its long-term growth plans. The company provides data warehouse appliances to enterprises, mid-market companies and government agencies worldwide. We were able to build a position in the name following a shareholder distribution by initial venture investors. Since then, the stock has rebounded to pre-distribution prices and the company has reported solid operational results.

Our investment in ICx Technologies (ICXT), a broken IPO during the fall of 2007, was our most significant contributor to the Fund during the second quarter as the name seemingly found buyer support. We met with management on one of their trips to New York, and we were further impressed with the long-term strategy of the company and its management team. We expect with any change during the presidential election to see a continued need for security and monitoring systems both at a governmental and commercial level.

As we had discussed in our first quarter letter, our position in Genesee & Wyoming (GWR), a short haul railroad, proved to continue to be a strong holding for the Fund. It was the beneficiary of a resource led export boom in both the U.S. and Australia, with particular exposure to coal. The name has been a perennial name in NESGX and due to valuation metrics we exited the position during the quarter near its 52-week high.

Our long time, largest Fund position in Bright Horizons Family Solutions (BFAM) was closed out as a result of its takeover by Bain Capital. The position continued to provide NESGX upside throughout the first half of the year and limited downside risk during the volatile period.

Investment Outlook

The economic outlook continues to remain uncertain as the full impact of the financial crisis affects multiple areas of the economy domestically and globally. Even with the help of monetary and fiscal stimulus, the world economy has begun to slow although it has failed to reach the “definitional” status of a recession. We believe the U.S. economy has been in a recession and will continue to feel recessionary until the credit and housing crisis has been flushed through the system. We remain cautious on exposure to the consumer and financial institutions, specifically regional banks and specialty financing companies. We have begun to see a crack in high energy prices, which may help to alleviate pressures on the economy, but we would need to see a more extended price reduction to feel comfortable that the worst has passed.

At the same time, we have been able during the first half of the year to invest in a handful of new small cap names that are trading at substantial valuation discounts to their historical averages. Small cap names that suffered dramatic share price declines in the first quarter of 2008 have offered some refuge to investors looking for strong long-term growth opportunities at reasonable valuation levels. Although these names are not immune to economic downturns, they can offer a patient investor a good portfolio of investments in preparation for an economic recovery. We will continue to invest opportunistically on price pullbacks in well managed companies, and will remain vigilant in these volatile and uncertain economic times.

Closing

As the newly appointed Portfolio Manager of NSCGF during the first half of 2008, I want to thank you again for your continued support. If you have any questions, thoughts or concerns, please do not hesitate to contact us at (800) 625-7071 or visit our Web site at www.needhamfunds.com.

Sincerely,

A handwritten signature in black ink on a light gray rectangular background. The signature reads "Chris Retzler" in a cursive, flowing script.

Chris Retzler
Portfolio Manager

This report is not an offer of the Needham Small Cap Growth Fund. Shares are sold only through the currently effective prospectus, which must precede or accompany this report. *Please read the prospectus and consider the investment objectives, risks, and charges and expenses of the Fund carefully before you invest. The prospectus contains this and other information about the Fund. Investment returns and principal value will fluctuate, and when redeemed, shares may be worth more or less than their original cost. Shares held less than 60 days are subject to a short-term redemption fee of 2%. The results contained in this report represent past performance of the Fund. Past performance does not guarantee future results and current performance may be higher or lower than these results. Current month-end performance is available at www.needhamfunds.com.* Total return figures include reinvestment of all dividends and capital gains. The investment risks of the Fund are increased by the Fund's non-diversified status and by the Fund's ability to invest in smaller company stocks, privately held companies and IPOs. Also, the Fund's use of short sales, options, futures strategies and leverage may result in significant capital loss. Funds holding smaller capitalized companies are subject to greater price fluctuation than those of larger companies.

To obtain a copy of the Fund's current prospectus, please contact the Fund's transfer agent, Citi Fund Services Ohio, Inc., at (800) 625-7071.

Needham & Company, LLC, member NASD/SIPC, is the distributor of The Needham Funds, Inc.

Exhibit A

Our performance relative to the major indices for these periods is as follows:

	2Q08 ⁽⁶⁾	1 Year ⁽⁷⁾	3 Years ⁽⁸⁾⁽⁹⁾⁽¹⁰⁾	5 Years ⁽⁸⁾⁽¹¹⁾⁽¹²⁾	Since Inception ⁽⁸⁾⁽¹³⁾⁽¹⁴⁾
Needham Small Cap Growth Fund ⁽¹⁾⁽²⁾	2.73%	-10.12%	2.57%	8.44%	11.55%
Needham Small Cap Growth Fund (after taxes on distributions)	2.73%	-12.75%	-0.10%	6.73%	10.11%
Needham Small Cap Growth Fund (after taxes on distributions and redemption)	1.77%	-2.86%	2.29%	7.40%	10.23%

Benchmarks	2Q08 ⁽⁶⁾	1 Year ⁽⁷⁾	3 Years ⁽⁸⁾⁽¹⁰⁾	5 Years ⁽⁸⁾⁽¹²⁾	Since Inception ⁽⁸⁾⁽¹⁴⁾
S&P 500 Index ⁽³⁾	-2.73%	-13.12%	4.40%	7.57%	4.95%
NASDAQ Composite Index ⁽⁴⁾	0.82%	-11.19%	4.51%	7.90%	6.62%
Russell 2000 Index ⁽⁵⁾	0.58%	-16.19%	3.82%	10.32%	7.22%

1. Total Annual Fund Operating Expenses are 2.50%.
2. Investment results calculated after reinvestment of dividends.
3. The S&P 500 Index is a broad unmanaged measure of the U.S. stock market.
4. The NASDAQ Composite Index is a broad-based capitalization-weighted index of all NASDAQ Global Market and Small-Cap stocks.
5. The Russell 2000 Index is a broad unmanaged index composed of the smallest 2,000 companies in the Russell 3000 Index.
6. 4/1/08 – 6/30/08.
7. 7/1/07 – 6/30/08.
8. Compound annual growth rate. Assumes all dividends are reinvested in shares of the Fund.
9. Cumulative return for the three years was 7.89%, assuming all dividends were reinvested in shares of the Fund.
10. 7/1/05 – 6/30/08 (annualized return).
11. Cumulative return for the five years was 49.98%, assuming all dividends were reinvested in shares of the Fund.
12. 7/1/03 – 6/30/08 (annualized return).
13. Cumulative return since inception was 94.97%, assuming all dividends were reinvested in shares of the Fund.
14. The inception date of the Fund was 5/22/02. 5/22/02 – 6/30/08 (annualized return).

Note: The average annual returns shown in the above table and accompanying footnotes are historical, reflect changes in share price and are net of expenses. Investment results and the principal value of an investment will vary. Past performance noted above does not guarantee future results. When shares are redeemed, they may be worth more or less than their original cost. Since inception, the Fund's Adviser has absorbed certain expenses of the Fund, without which returns would have been lower.

The after-tax returns are shown in two ways: (1) assuming that an investor owned the Fund during the entire period and paid taxes on the Fund's distributions; and (2) assuming that an investor paid taxes on the Fund's distributions and sold all shares at the end of each period.

After-tax returns are calculated using the highest historical individual federal income tax rate and do not reflect the impact of state and local taxes. Actual after-tax returns depend on an investor's tax situation and may differ from those shown, and after-tax returns shown are not relevant to investors who hold their Fund shares through tax-deferred arrangements, such as 401(k) plans or individual retirement accounts.