

SAFEGUARD SCIENTIFICS INC  
Form 10-Q  
October 25, 2013

SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Quarterly Period Ended September 30, 2013

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 1-5620

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Safeguard Scientifics, Inc.  
(Exact name of registrant as specified in its charter)

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Pennsylvania  
(State or other jurisdiction of  
incorporation or organization)

23-1609753  
(I.R.S. Employer ID No.)

435 Devon Park Drive  
Building 800  
Wayne, PA  
(Address of principal executive offices)  
(610) 293-0600

19087  
(Zip Code)

Registrant's telephone number, including area code

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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 and 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 (§232.405 of this chapter) 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 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

Number of shares outstanding as of October 24, 2013

Common Stock 21,518,410



SAFEGUARD SCIENTIFICS, INC.  
QUARTERLY REPORT ON FORM 10-Q  
TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

	Page
Item 1 – Financial Statements:	
<u>Consolidated Balance Sheets (unaudited) – September 30, 2013 and December 31, 2012</u>	<u>3</u>
<u>Consolidated Statements of Operations (unaudited) – Three and Nine Months Ended September 30, 2013 and 2012</u>	<u>4</u>
<u>Consolidated Statements of Comprehensive Loss (unaudited) – Three and Nine Months Ended September 30, 2013 and 2012</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows (unaudited) – Nine Months Ended September 30, 2013 and 2012</u>	<u>6</u>
<u>Consolidated Statement of Changes in Equity (unaudited) – Nine Months Ended September 30, 2013</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements (unaudited)</u>	<u>8</u>
<u>Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>20</u>
<u>Item 3 – Quantitative and Qualitative Disclosures About Market Risk</u>	<u>39</u>
<u>Item 4 – Controls and Procedures</u>	<u>39</u>
PART II – OTHER INFORMATION	
<u>Item 1A – Risk Factors</u>	<u>40</u>
<u>Item 6 – Exhibits</u>	<u>41</u>
<u>Signatures</u>	<u>42</u>

SAFEGUARD SCIENTIFICS, INC.  
CONSOLIDATED BALANCE SHEETS  
(In thousands, except per share data)

	September 30, 2013	December 31, 2012
	(Unaudited)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 108,694	\$ 66,029
Cash held in escrow	—	6,434
Marketable securities	54,132	110,957
Restricted marketable securities	5	10
Prepaid expenses and other current assets	1,275	2,408
Total current assets	164,106	185,838
Property and equipment, net	160	193
Ownership interests in and advances to partner companies and funds (of which \$14,560 and \$20,972 are measured at fair value at September 30, 2013 and December 31, 2012, respectively)	143,048	148,639
Loan participations receivable	8,279	7,085
Available-for-sale securities	32	58
Long-term marketable securities	3,292	29,059
Other assets	2,826	3,272
Total Assets	\$ 321,743	\$ 374,144
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Convertible senior debentures—current	\$ 470	\$ —
Accounts payable	374	610
Accrued compensation and benefits	3,552	4,050
Accrued expenses and other current liabilities	3,540	2,601
Total current liabilities	7,936	7,261
Other long-term liabilities	3,814	3,921
Convertible senior debentures—non-current	49,221	48,991
Total Liabilities	60,971	60,173
Commitments and contingencies		
Equity:		
Preferred stock, \$0.10 par value; 1,000 shares authorized	—	—
Common stock, \$0.10 par value; 83,333 shares authorized; 21,519 and 20,968 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	2,152	2,097
Additional paid-in capital	822,170	815,946
Accumulated deficit	(563,564	) (504,072 )
Accumulated other comprehensive income	14	—
Total Equity	260,772	313,971
Total Liabilities and Equity	\$ 321,743	\$ 374,144
See Notes to Consolidated Financial Statements.		



SAFEGUARD SCIENTIFICS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited—In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
General and administrative expense	\$4,835	\$4,790	\$16,924	\$14,681
Operating loss	(4,835	) (4,790	) (16,924	) (14,681
Other income (loss), net	(4,224	) 91	(6,191	) 7,994
Interest income	572	696	2,096	2,190
Interest expense	(1,077	) (1,461	) (3,220	) (4,369
Equity loss	(9,866	) (3,293	) (35,253	) (19,688
Net loss before income taxes	(19,430	) (8,757	) (59,492	) (28,554
Income tax benefit (expense)	—	—	—	—
Net loss	\$(19,430	) \$(8,757	) \$(59,492	) \$(28,554
Net loss per share:				
Basic and diluted	\$ (0.90	) \$ (0.42	) \$ (2.80	) \$ (1.36
Weighted average shares used in computing basic and diluted loss per share:	21,494	20,999	21,245	20,935

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 (Unaudited – In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net loss	\$(19,430	) \$(8,757	) \$(59,492	) \$(28,554
Other comprehensive income (loss), before taxes:				
Unrealized net gain (loss) on available-for-sale securities	14	(1,390	) (26	) 4,410
Reclassification adjustment for other than temporary impairment of available-for-sale securities included in net loss	—	94	40	238
Total comprehensive loss	\$(19,416	) \$(10,053	) \$(59,478	) \$(23,906
See Notes to Consolidated Financial Statements.				

SAFEGUARD SCIENTIFICS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited – In thousands)

	Nine Months Ended September 30,	
	2013	2012
Cash Flows from Operating Activities:		
Net cash used in operating activities	\$(16,299 )	\$(12,616 )
Cash Flows from Investing Activities:		
Proceeds from sales of and distributions from companies and funds	2,603	14,526
Advances and loans to companies	(9,350 )	(13,315 )
Origination fees on mezzanine loans	42	74
Acquisitions of ownership interests in companies and funds	(28,718 )	(21,719 )
Increase in marketable securities	(47,072 )	(209,876 )
Decrease in marketable securities	129,664	226,133
Repayment of advances and loans to companies	1,044	3,214
Capital expenditures	(37 )	(25 )
Proceeds from sale of discontinued operations, net	6,434	—
Net cash provided by (used in) investing activities	54,610	(988 )
Cash Flows from Financing Activities:		
Repurchase of convertible senior debentures	(43 )	—
Issuance of Company common stock, net	4,397	1,568
Net cash provided by financing activities	4,354	1,568
Net Increase (Decrease) in Cash and Cash Equivalents	42,665	(12,036 )
Cash and Cash Equivalents at beginning of period	66,029	83,187
Cash and Cash Equivalents at end of period	\$108,694	\$71,151
See Notes to Consolidated Financial Statements.		



SAFEGUARD SCIENTIFICS, INC.  
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
(Unaudited – In thousands)

	Total Equity	Accumulated Deficit	Accumulated Other Comprehensive Income	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital
Balance — December 31, 2012	\$313,971	\$(504,072 )	\$ —	20,968	\$2,097	\$815,946
Net loss	(59,492 )	(59,492 )	—	—	—	—
Stock options exercised, net	4,397	—	—	551	55	4,342
Issuance of restricted stock, net	74	—	—	—	—	74
Stock-based compensation expense	1,808	—	—	—	—	1,808
Other comprehensive income	14	—	14	—	—	—
Balance — September 30, 2013	\$260,772	\$(563,564 )	\$ 14	21,519	\$2,152	\$822,170

See Notes to Consolidated Financial Statements.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. General

The accompanying unaudited interim Consolidated Financial Statements of Safeguard Scientifics, Inc. (“Safeguard” or the “Company”) were prepared in accordance with accounting principles generally accepted in the United States of America and the interim financial statement rules and regulations of the SEC. In the opinion of management, these statements include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Consolidated Financial Statements. The interim operating results are not necessarily indicative of the results for a full year or for any interim period. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations relating to interim financial statements. The Consolidated Financial Statements included in this Form 10-Q should be read in conjunction with Management’s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-Q and with the Company’s Consolidated Financial Statements and Notes thereto included in the Company’s 2012 Annual Report on Form 10-K.

## 2. Ownership Interests in and Advances to Partner Companies and Funds

The following summarizes the carrying value of the Company’s ownership interests in and advances to partner companies and private equity funds.

	September 30, 2013	December 31, 2012
	(In thousands)	
	(Unaudited)	
Fair value	\$ 14,560	\$ 20,972
Equity Method:		
Partner companies	108,249	102,931
Private equity funds	3,606	3,810
	111,855	106,741
Cost Method:		
Partner companies	12,530	10,000
Private equity funds	2,518	2,634
	15,048	12,634
Advances to partner companies	1,585	8,292
	\$ 143,048	\$ 148,639
Loan participations receivable	\$ 8,279	\$ 7,085
Available-for-sale securities	\$ 32	\$ 58

The Company recognized an impairment charge of \$1.3 million in the three months ended September 30, 2013 related to PixelOptics, Inc. (“PixelOptics”) which is reflected in Equity loss in the Consolidated Statements of Operations. The impairment was based on PixelOptics’ inability to raise additional capital from independent sources to continue its operations. The Company previously recorded impairment charges of \$9.9 million and \$3.7 million related to PixelOptics in the second quarters of 2013 and 2012, respectively. The adjusted carrying value of PixelOptics at September 30, 2013 was \$0. The Company believes it is unlikely it will recover any of its capital.

For the three and nine months ended September 30, 2013, the Company recognized an unrealized loss of \$4.8 million and \$6.4 million, respectively, on the mark-to-market of its holdings in NuPathe Inc. (“NuPathe”), which is included in Other income (loss), net in the Consolidated Statements of Operations.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following unaudited summarized results of operations for the six months ended June 30, 2013 and 2012 for PixelOptics have been compiled from the unaudited financial statements of PixelOptics. The results of PixelOptics are reported on a one quarter lag.

	Six Months Ended June 30,	
	2013	2012
	(In thousands)	
	(Unaudited)	
Results of Operations:		
Revenue	\$800	\$569
Operating loss	\$(12,219 )	\$(16,172 )
Net loss	\$(14,838 )	\$(16,925 )

### 3. Acquisitions of Ownership Interests in Partner Companies and Funds

In September and June 2013, the Company funded an aggregate of \$0.6 million of convertible bridge loans to Alverix, Inc. ("Alverix"). The Company had previously deployed an aggregate of \$8.8 million in Alverix. Alverix provides next-generation instrument and connectivity platforms for diagnostic Point-of-Care testing. The Company accounts for its interest in Alverix under the equity method.

In August 2013, the Company acquired a 34.4% primary ownership interest in Quantia, Inc. ("Quantia") for \$7.5 million. Quantia provides a mobile and web-based physician relationship management platform, QuantiaMD, which enables principal participants throughout the healthcare spectrum, including health systems, payers, pharmaceutical companies and medical device companies, to engage and interact with their physicians. The Company accounts for its interest in Quantia under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Quantia was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In August 2013, the Company deployed an additional \$1.1 million into DriveFactor, Inc. ("DriveFactor"). The Company previously deployed an aggregate of \$3.5 million in DriveFactor. DriveFactor is a provider of telematics technology and statistical analysis of driving data. The Company accounts for its interest in DriveFactor under the equity method. The difference between the Company's cost and its interest in the underlying net assets of DriveFactor was allocated to goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In August 2013, the Company deployed \$5.0 million in Clutch Holdings, Inc. ("Clutch"). The Company previously had acquired an interest in Clutch in February 2013 for \$0.5 million. In conjunction with the most recent funding, the Company's primary ownership interest in Clutch increased from 6.5% to 24.0%, above the threshold at which the Company believes it exercises significant influence. Accordingly, the Company adopted the equity method of accounting for its holdings in Clutch. The difference between the Company's cost and its interest in the underlying net assets of Clutch was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets. The change in accounting treatment for the Company's holdings in Clutch from the cost method to the equity method had no effect on the Consolidated Financial Statements of any prior period. Clutch is a mobile commerce platform that unifies applications associated with gifting, loyalty and shopping programs to improve the customer experience.

In July 2013, the Company funded \$1.0 million of a convertible bridge loan to Crescendo Bioscience, Inc. ("Crescendo Bioscience"). The Company previously had acquired an interest in Crescendo Bioscience in December 2012 for \$10.0 million. Crescendo Bioscience is a molecular diagnostics laboratory focused on rheumatology. The Company accounts for its ownership interest in Crescendo Bioscience under the cost method.

During the nine months ended September 30, 2013, the Company funded \$2.3 million for participations in loan and equity interests initiated by Penn Mezzanine. Included in this funding were \$2.2 million for participation in a loan and

\$0.1 million for participation in equity of the borrower acquired by Penn Mezzanine.

During the nine months ended September 30, 2013, the Company funded an aggregate of \$5.3 million of a convertible bridge loan to PixelOptics. The Company previously deployed an aggregate of \$31.6 million in PixelOptics.

PixelOptics provides electronic corrective eyeglasses designed to substantially reduce or eliminate the visual distortion and other limitations associated with multifocal lenses. The Company accounts for its interest in PixelOptics under the equity method. As previously noted, the adjusted carrying value of PixelOptics at September 30, 2013 was \$0.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In June 2013, the Company deployed an additional \$5.3 million into Medivo, Inc. (“Medivo”). The Company had previously acquired an interest in Medivo in November 2011 for \$6.3 million. Medivo is a cloud-based health monitoring platform that connects doctors, consumers and clinical labs. The Company accounts for its interest in Medivo under the equity method. With respect to the June 2013 deployment, the difference between the Company’s cost and its incremental interest in the underlying net assets of Medivo was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In May 2013, the Company funded \$0.2 million of a convertible bridge loan to Hoopla Software, Inc. (“Hoopla”). The Company had previously acquired an interest in Hoopla in December 2011 for \$1.3 million. Hoopla helps organizations create high performance sales cultures through software-as-a-service solutions that integrate with customer relationship management systems. The Company accounts for its interest in Hoopla under the equity method.

In March 2013, the Company deployed an additional \$1.7 million into Lumesis, Inc. (“Lumesis”). The Company had previously acquired an interest in Lumesis in February 2012 for \$2.2 million. Lumesis is a financial technology company that is dedicated to delivering software solutions and comprehensive, timely data to the municipal bond marketplace. The Company accounts for its interest in Lumesis under the equity method. The difference between the Company’s cost and its interest in the underlying net assets of Lumesis was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In February 2013, the Company acquired a 27.6% primary ownership interest in Pneuron Corporation (“Pneuron”) for \$5.0 million. Pneuron helps enterprise companies reduce the time and cost of application development by building solutions across heterogeneous databases and applications. The Company accounts for its ownership interest in Pneuron under the equity method. The difference between the Company’s cost and its interest in the underlying net assets of Pneuron was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In January 2013, the Company acquired a 7.7% primary interest in Sotera Wireless, Inc. (“Sotera Wireless”). The Company deployed \$1.3 million into Sotera Wireless and acquired additional shares from a previous investor for \$1.2 million. Sotera Wireless is a medical device company that has developed a wireless patient monitoring platform that is designed to keep clinicians connected to their patients. The Company accounts for its interest in Sotera Wireless under the cost method.

#### 4. Fair Value Measurements

The Company categorizes its financial instruments into a three-level fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the instrument. Financial assets recorded at fair value on the Company’s Consolidated Balance Sheets are categorized as follows:

Level 1—Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2—Include other inputs that are directly or indirectly observable in the marketplace.

Level 3—Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table provides the carrying value and fair value of certain financial assets and liabilities of the Company measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012:

	Carrying Value	Fair Value Measurement at September 30, 2013		
		Level 1	Level 2	Level 3
	(In thousands)			
	(Unaudited)			
Cash and cash equivalents	\$108,694	\$108,694	\$—	\$—
Restricted marketable securities	5	5	—	—
Ownership interest in common stock of NuPathe	12,437	12,437	—	—
Ownership interest in warrants and options of NuPathe	2,123	—	—	2,123
Available-for-sale securities	32	32	—	—
Warrant participations	417	—	—	417
Marketable securities—held-to-maturity:				
Commercial paper	\$23,749	\$23,749	\$—	\$—
U.S. Treasury Bills	16,181	16,181	—	—
Government agency bonds	2,645	2,645	—	—
Certificates of deposit	14,849	14,849	—	—
Total marketable securities	\$57,424	\$57,424	\$—	\$—
	Carrying Value	Fair Value Measurement at December 31, 2012		
	(In thousands)	Level 1	Level 2	Level 3
	(Unaudited)			
Cash and cash equivalents	\$66,029	\$66,029	\$—	\$—
Cash held in escrow	6,434	6,434	—	—
Restricted marketable securities	10	10	—	—
Ownership interest in common stock of NuPathe	8,897	8,897	—	—
Ownership interest in preferred stock, warrants and options of NuPathe	12,075	—	—	12,075
Available-for-sale securities	58	58	—	—
Warrant participations	423	—	—	423
Marketable securities—held-to-maturity:				
Commercial paper	\$50,932	\$50,932	\$—	\$—
U.S. Treasury Bills	21,352	21,352	—	—
Government agency bonds	45,909	45,909	—	—
Certificates of deposit	21,823	21,823	—	—
Total marketable securities	\$140,016	\$140,016	\$—	\$—

As of September 30, 2013, \$54.1 million of marketable securities had contractual maturities which were less than one year and \$3.3 million of marketable securities had contractual maturities greater than one year. Held-to-maturity securities are carried at amortized cost, which, due to the short-term maturity of these instruments, approximates fair value using quoted prices in active markets for identical assets or liabilities defined as Level 1 inputs under the fair value hierarchy.

The Company recorded an impairment charge of \$1.3 million related to PixelOptics in the three months ended September 30, 2013, measured as the amount by which PixelOptics' carrying value exceeded its estimated fair value.

The Company also recorded an impairment charge of \$9.9 million related to PixelOptics in the three months ended June 30, 2013. The fair market value of the Company's equity ownership in PixelOptics was determined to be \$0 at September 30, 2013 based on Level 3 inputs as defined above. The inputs and valuation techniques used were

primarily an evaluation of discounted cash flows for PixelOptics.

The Company's Penn Mezzanine warrant participations are carried at fair value. The value of the Company's holdings in warrant participations is measured by reference to Level 3 inputs. The inputs and valuation techniques used include discounted

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

cash flows and valuation of comparable public companies. The Company recorded an impairment charge of \$0.3 million related to its Penn Mezzanine debt and equity participations in the second quarter of 2013 measured as the amount by which the carrying value of the Company's participation in the debt, equity and warrant interests acquired by Penn Mezzanine exceeded their estimated fair values.

The Company's ownership interests in NuPathe are accounted for at fair value. In February 2013, the Company converted its 2,500 shares of preferred stock units, acquired in October 2012, into 2.5 million shares of common stock in NuPathe. The preferred stock units had been valued using Level 3 inputs. The fair value of the Company's ownership interest in NuPathe's common stock was measured using quoted market prices for NuPathe's common stock as traded on the NASDAQ Global Market, which is considered a Level 1 input under the valuation hierarchy. The fair value of the Company's ownership interest in NuPathe's warrants and options was measured using a Black-Scholes option pricing model, which is based on Level 3 inputs as defined above.

#### 5. Convertible Debentures and Credit Arrangements

The carrying values of the Company's convertible senior debentures were as follows:

	September 30, 2013 (In thousands) (Unaudited)	December 31, 2012
Convertible senior debentures due 2018	\$49,221	\$48,483
Convertible senior debentures due 2014	29	67
Convertible senior debentures due 2024	441	441
	49,691	48,991
Less: current portion	(470)	—
Convertible senior debentures – non current	\$49,221	\$48,991
Convertible Senior Debentures due 2018		

In November 2012, Safeguard issued \$55.0 million principal amount of its 5.25% convertible senior debentures due 2018 (the "2018 Debentures"). Proceeds from the offering were used to repurchase substantially all of the Company's then outstanding 10.125% convertible senior debentures due 2014 (the "2014 Debentures"). Interest on the 2018 Debentures is payable semi-annually on May 15 and November 15.

Holders of the 2018 Debentures may convert their notes prior to November 15, 2017 at their option only under the following circumstances:

during any calendar quarter commencing after the calendar quarter ending on December 31, 2012, if the last reported sale price of the common stock for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

during the five business day period after any five consecutive trading day period in which the trading price per \$1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on such trading day;

if the notes have been called for redemption; or

upon the occurrence of specified corporate events.

On or after November 15, 2017, until the close of business on the second business day immediately preceding the maturity date, holders may convert their notes at any time, regardless of whether any of the foregoing conditions has been met. Upon conversion, the Company will satisfy its conversion obligation by paying or delivering, as the case may be, cash, shares of common stock or a combination of cash and shares of our common stock, at the Company's election.

The conversion rate of the 2018 Debentures is 55.17 shares of common stock per \$1,000 principal amount of debentures, equivalent to a conversion price of approximately \$18.13 per share of common stock. The closing price per share of the Company's common stock at September 30, 2013 was \$15.69.



On or after November 15, 2016, the Company may redeem for cash any of the 2018 Debentures if the last reported sale price of the Company's common stock exceeds 140% of the conversion price for at least 20 trading days during the period of 30 consecutive trading days ending on the trading day before the date that notice of redemption is given, including the last trading

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

day of such period. Upon any redemption of the 2018 Debentures, the Company will pay a redemption price of 100% of their principal amount, plus accrued and unpaid interest to, but excluding, the date of redemption, and additional interest, if any.

The 2018 Debenture holders have the right to require the Company to repurchase the 2018 Debentures if the Company undergoes a fundamental change, which includes the sale of all or substantially all of the Company's common stock or assets; liquidation; dissolution; a greater than 50% change in control; the delisting of the Company's common stock from the New York Stock Exchange or the NASDAQ Global Market (or any of their respective successors); or a substantial change in the composition of the Company's board of directors as defined in the governing agreement. Holders may require that the Company repurchase for cash all or part of their 2018 Debentures at a fundamental change repurchase price equal to 100% of the principal amount of the debentures to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

Because the 2018 Debentures may be settled in cash or partially in cash upon conversion, the Company separately accounts for the liability and equity components of the 2018 Debentures. The carrying amount of the liability component was determined at the transaction date by measuring the fair value of a similar liability that does not have an associated equity component. The carrying amount of the equity component represented by the embedded conversion option was determined by deducting the fair value of the liability component from the initial proceeds of the 2018 Debentures as a whole. At September 30, 2013, the fair value of the \$55.0 million outstanding 2018 Debentures was approximately \$59.4 million, based on the midpoint of the bid and ask prices as of such date. At September 30, 2013, the carrying amount of the equity component was \$6.4 million, the principal amount of the liability component was \$55.0 million, the unamortized discount was \$5.8 million and the net carrying value of the liability component was \$49.2 million. The Company is amortizing the excess of the face value of the 2018 Debentures over their carrying value over their term as additional interest expense using the effective interest method and recorded \$0.7 million of such expense for the nine months ended September 30, 2013. The effective interest rate on the 2018 Debentures is 8.7%.

#### Convertible Senior Debentures due 2024

In 2004, the Company issued an aggregate of \$150.0 million in face value of convertible senior debentures with a stated maturity date of March 15, 2024 (the "2024 Debentures"). At September 30, 2013, the fair value of the \$0.4 million outstanding 2024 Debentures approximated their carrying value, based on the midpoint of bid and ask prices as of such date. Interest on the 2024 Debentures is payable semi-annually. At the debenture holders' option, the 2024 Debentures are convertible into the Company's common stock through March 14, 2024, subject to certain conditions. The adjusted conversion rate of the 2024 Debentures is \$43.3044 of principal amount per share. The remaining 2024 Debenture holders have the right to require the Company to repurchase the 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their face amount, plus accrued and unpaid interest. In limited circumstances, the Company has the right to redeem all or some of the 2024 Debentures.

#### Convertible Senior Debentures due 2014

In March 2010, the Company issued an aggregate of \$46.9 million of the 2014 Debentures. As noted above, in November 2012, the Company repurchased substantially all of the 2014 Debentures for \$58.7 million plus accrued interest.

#### Credit Arrangements

The Company is party to a loan agreement with a commercial bank which provides it with a revolving credit facility in the maximum aggregate amount of \$50 million in the form of borrowings, guarantees and issuances of letters of credit (subject to a \$20 million sublimit). Actual availability under the credit facility is based on the amount of cash maintained at the bank as well as the value of the Company's public and private partner company interests. This credit facility bears interest at the prime rate for outstanding borrowings, subject to an increase in certain circumstances. Other than for limited exceptions, the Company is required to maintain all of its depository and operating accounts and the lesser of \$80 million or 75% of its investment and securities accounts at the bank. The credit facility, as amended, matures on December 31, 2014. Under the credit facility, the Company provided a \$6.3 million letter of

credit expiring on March 19, 2019 to the landlord of CompuCom Systems, Inc.'s Dallas headquarters which was required in connection with the sale of CompuCom Systems in 2004. Availability under the Company's revolving credit facility at September 30, 2013 was \$43.7 million.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 6. Stock-Based Compensation

Stock-based compensation expense was recognized in the Consolidated Statements of Operations as follows:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	2012	2013	2012	2013
	(In thousands) (Unaudited)			
General and administrative expense	\$510	\$317	\$1,808	\$1,546
	\$510	\$317	\$1,808	\$1,546

The fair value of the Company's stock-based awards to employees was estimated at the date of grant using the Black-Scholes option-pricing model. The risk-free rate was based on the U.S. Treasury yield curve in effect at the end of the quarter in which the grant occurred. The expected term of stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility measured using weekly price observations of the Company's common stock for a period equal to the stock option's expected term. At September 30, 2013, the Company had outstanding options that vest based on three different types of vesting schedules:

- 1) market-based;
- 2) performance-based; and
- 3) service-based.

Market-based awards entitle participants to vest in a number of options determined by achievement by the Company of certain target market capitalization increases (measured by reference to stock price increases on a specified number of outstanding shares) over an eight-year period. The requisite service periods for the market-based awards are based on the Company's estimate of the dates on which the market conditions will be met as determined using a Monte Carlo simulation model. Compensation expense is recognized over the requisite service periods using the straight-line method but is accelerated if market capitalization targets are achieved earlier than estimated. During the nine months ended September 30, 2013 and 2012, respectively, the Company did not issue any market-based option awards to employees. During the nine months ended September 30, 2013 and 2012, respectively, no options vested based on achievement of market capitalization targets. During the three months ended September 30, 2013, 499 thousand unvested market-based awards expired by their terms. The Company recorded compensation expense related to market-based option awards of \$0.0 million and \$0.1 million for the three months ended September 30, 2013 and 2012, respectively, and \$0.2 million and \$0.3 million for the nine months ended September 30, 2013 and 2012, respectively. Depending on the Company's stock performance, the maximum number of unvested shares at September 30, 2013 attainable under these grants was 457 thousand shares.

Performance-based awards entitle participants to vest in a number of awards determined by achievement by the Company of target capital returns based on net cash proceeds received by the Company on the sale, merger or other exit transaction of certain identified partner companies. Vesting may occur, if at all, once per year. The requisite service periods for the performance-based awards are based on the Company's estimate of when the performance conditions will be met. Compensation expense is recognized for performance-based awards for which the performance condition is considered probable of achievement. Compensation expense is recognized over the requisite service periods using the straight-line method but is accelerated if capital return targets are achieved earlier than estimated. During the nine months ended September 30, 2013 and 2012, respectively, the Company did not issue any performance-based awards to employees. During the nine months ended September 30, 2013 and 2012, respectively, 0 and 14 thousand performance-based awards vested. During the nine months ended September 30, 2013 and 2012, respectively, 16 thousand and 0 performance-based awards were canceled or forfeited. The Company recorded compensation expense related to performance-based option awards of \$0.1 million and \$0.0 million for the three months ended September 30, 2013 and 2012, respectively, and \$0.3 million and \$0.1 million for the nine months

ended September 30, 2013 and 2012, respectively. The maximum number of unvested shares at September 30, 2013 attainable under these option grants was 795 thousand shares.

All other outstanding options are service-based awards that generally vest over four years after the date of grant and expire eight years after the date of grant. Compensation expense is recognized over the requisite service period using the straight-line method. The requisite service period for service-based awards is the period over which the award vests. During the nine months ended September 30, 2013 and 2012, respectively, the Company issued 39 thousand and 46 thousand service-based option awards to employees. The Company recorded compensation expense related to service-based option awards of \$0.2

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

million and \$0.1 million for the three months ended September 30, 2013 and 2012, and \$0.4 million and \$0.5 million for the nine months ended September 30, 2013 and 2012, respectively.

During the nine months ended September 30, 2013 and 2012, respectively, the Company issued 46 thousand and 23 thousand deferred stock units to non-employee directors for annual service grants or fees earned during the preceding quarter. Deferred stock units issued to directors in lieu of directors fees are 100% vested at the grant date; matching deferred stock units equal to 25% of directors' fees deferred vest one year following the grant date or, if earlier, upon reaching age 65. Deferred stock units are payable in stock on a one-for-one basis. Payments related to the deferred stock units are generally distributable following termination of employment or service, death or permanent disability. Total compensation expense for deferred stock units, performance-based stock units and restricted stock was approximately \$0.3 million and \$0.1 million for the three months ended September 30, 2013 and 2012, and \$1.0 million and \$0.6 million for the nine months ended September 30, 2013 and 2012, respectively. During the nine months ended September 30, 2012, the Company issued five thousand unrestricted shares to members of its advisory board, and recorded expense of \$0.1 million related to these awards.

#### 7. Income Taxes

The Company's consolidated income tax benefit (expense) was \$0.0 million for the three and nine months ended September 30, 2013 and 2012. The Company has recorded a valuation allowance to reduce its net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the tax benefit related to the net operating losses that would have been recognized in the three and nine months ended September 30, 2013 and 2012 were offset by changes in the valuation allowance.

During the three and nine months ended September 30, 2013, the Company had no material changes in uncertain tax positions.

#### 8. Net Loss Per Share

The calculations of net loss per share were as follows:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
	2013	2012	2013	2012
	(In thousands except per share data)			
	(Unaudited)			
Basic and Diluted:				
Net loss	\$(19,430 )	\$(8,757 )	\$(59,492 )	\$(28,554 )
Weighted average common shares outstanding	21,494	20,999	21,245	20,935
Net loss per share	\$(0.90 )	\$(0.42 )	\$(2.80 )	\$(1.36 )

Basic and diluted average common shares outstanding for purposes of computing net loss per share includes outstanding common shares and vested deferred stock units (DSUs).

If a consolidated or equity method partner company has dilutive stock options, unvested restricted stock, DSUs or warrants, diluted net loss per share is computed by first deducting the income attributable to the potential exercise of the dilutive securities of the partner company from net loss. Any impact is shown as an adjustment to net loss for purposes of calculating diluted net loss per share.

The following potential shares of common stock and their effects on net loss were excluded from the diluted net loss per share calculation because their effect would be anti-dilutive:

For the three and nine months ended September 30, 2013 and 2012, options to purchase 2.3 million and 3.1 million shares of common stock, respectively, at prices ranging from \$3.93 to \$18.80 for both periods, were excluded from the calculations.

For the three and nine months ended September 30, 2013 and 2012, unvested restricted stock units, performance stock units and DSUs convertible into 0.3 million and 0.2 million shares of stock, respectively, were excluded from the calculations.

- For the three and nine months ended September 30, 2013, 3.0 million shares of common stock representing the effect of the assumed conversion of the 2018 Debentures, were excluded from the calculation.
- For the three and nine months ended September 30, 2012, 2.8 million shares of common stock representing the effect of the assumed conversion of the 2014 Debentures, were excluded from the calculations.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 9. Operating Segments

In the fourth quarter of 2012, the Company expanded its focus within the former Life Sciences segment to include companies in the HealthTech sector and renamed that segment "Healthcare." The HealthTech sector had previously been included in the Company's Technology segment. AdvantEdge Healthcare Solutions, a provider of physician billing and practice management services and software, which had previously been reported within the Technology segment, is now reported under the Healthcare segment. As a result of the change, the Company has restated its previously reported segment disclosure information, to include the results of AdvantEdge Healthcare Solutions within the Healthcare segment.

As of September 30, 2013, the Company held interests in 22 non-consolidated partner companies which are included in the Healthcare and Technology segments. Included in the Penn Mezzanine segment are the Company's interests in the Penn Mezzanine management company and general partner and the Company's participations in mezzanine loans and equity interests initiated by Penn Mezzanine.

The Company's active partner companies by segment were as follows as of September 30, 2013:

## Healthcare

Partner Company	Safeguard Primary Ownership as of September 30, 2013	Accounting Method
AdvantEdge Healthcare Solutions, Inc.	40.2%	Equity
Alverix, Inc.	49.2%	Equity
Crescendo Bioscience, Inc.	12.6%	Cost
Good Start Genetics, Inc.	30.0%	Equity
Medivo, Inc.	34.5%	Equity
NovaSom, Inc.	30.3%	Equity
NuPathe Inc.	16.5%	Fair value (1)
PixelOptics, Inc.	24.6%	Equity
Putney, Inc.	27.6%	Equity
Quantia, Inc.	34.4%	Equity
Sotera Wireless, Inc.	7.4%	Cost

## Technology

Partner Company	Safeguard Primary Ownership as of September 30, 2013	Accounting Method
AppFirst, Inc.	34.5%	Equity
Beyond.com, Inc.	38.2%	Equity
Bridgevine, Inc.	22.7%	Equity
Clutch Holdings, Inc.	24.0%	Equity
DriveFactor, Inc.	40.6%	Equity
Hoopla Software, Inc.	25.3%	Equity
Lumesis, Inc.	44.2%	Equity
MediaMath, Inc.	22.5%	Equity
Pneuron Corporation	27.6%	Equity
Spongecell, Inc.	23.0%	Equity
ThingWorx, Inc.	39.8%	Equity

(1) The Company's ownership interest in NuPathe was accounted for as available-for-sale securities following NuPathe's completion of an initial public offering in August 2010. In October 2012, the Company participated in a private placement of NuPathe preferred stock units, and in conjunction with this financing, the Company placed two persons on NuPathe's board of directors. As a result, the Company determined that it exercised significant influence over NuPathe which made the equity method of accounting applicable to its ownership interests. Instead, the



Company elected the fair value option beginning in October 2012. Prior to August 2010, the Company accounted for NuPathe under the equity method.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of September 30, 2013, the Company has a 36% ownership interest in the management company and general partner of Penn Mezzanine L.P., which is included in the Penn Mezzanine segment. The Company accounts for its interest under the equity method.

Results of the Healthcare and Technology segments reflect the equity income (loss) of their respective equity method partner companies, other income (loss) associated with fair value method and cost method partner companies and the gains or losses on the sale of their respective partner companies. Results of the Penn Mezzanine segment includes interest, dividends and participation fees earned on the mezzanine interests in which the Company participates as well as equity income (loss) associated with the Company's management company and general partner interest in the Penn Mezzanine platform.

Management evaluates the Healthcare and Technology segments' performance based on net income (loss) which is impacted by the number of partner companies accounted for under the equity method, the Company's voting ownership percentage in these partner companies and the net results of operations of these partner companies, any impairment charges and gain (loss) on the sale of equity and cost method partner companies.

Management evaluates the Penn Mezzanine segment performance based on the performance of the mezzanine interests in which the Company participates. This includes an evaluation of the current and future cash flows associated with interest and dividend payments as well as estimated losses based on evaluating known and inherent risks in the investments in which the Company participates.

Other Items include certain expenses which are not identifiable to the operations of the Company's operating business segments. Other Items primarily consist of general and administrative expenses related to corporate operations, including employee compensation, insurance and professional fees, including legal and finance, interest income, interest expense and other income (loss) and equity income (loss) related to certain private equity fund ownership interests. Other Items also include income taxes, which are reviewed by management independent of segment results. As of September 30, 2013 and December 31, 2012, all of the Company's assets were located in the United States. Segment assets in Other Items included primarily cash, cash equivalents, cash held in escrow, and marketable securities of \$166.1 million and \$212.5 million, at September 30, 2013 and December 31, 2012, respectively.

## Three Months Ended September 30, 2013

	Healthcare	Technology	Penn Mezzanine	Total Segments	Other Items	Total
	(In thousands)					
	(Unaudited)					
Operating loss	\$—	\$—	\$(4 )	\$(4 )	\$(4,831 )	\$(4,835 )
Interest income	—	—	394	394	178	572
Equity income (loss)	(6,553 )	(3,490 )	(92 )	(10,135 )	269	(9,866 )
Net income (loss)	(11,325 )	(3,490 )	845	(13,970 )	(5,460 )	(19,430 )
Segment Assets:						
September 30, 2013	72,563	64,393	12,873	149,829	171,914	321,743
December 31, 2012	83,500	58,753	12,153	154,406	219,738	374,144

## Three months ended September 30, 2012

	Healthcare	Technology	Penn Mezzanine	Total Segments	Other Items	Total
	(In thousands)					
	(Unaudited)					
Operating loss	\$—	\$—	\$(2 )	\$(2 )	\$(4,788 )	\$(4,790 )
Interest income	—	—	322	322	374	696
Equity income (loss)	(5,727 )	2,508	(72 )	(3,291 )	(2 )	(3,293 )
Net income (loss)	(5,811 )	2,508	423	(2,880 )	(5,877 )	(8,757 )



## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Nine Months Ended September 30, 2013					
	Healthcare	Technology	Penn Mezzanine	Total Segments	Other Items	Total
	(In thousands)					
	(Unaudited)					
Operating loss	\$—	\$—	\$(13 )	\$(13 )	\$(16,911 )	\$(16,924 )
Interest income	—	—	1,118	1,118	978	2,096
Equity income (loss)	(27,303 )	(7,990 )	(256 )	(35,549 )	296	(35,253 )
Net income (loss)	(33,665 )	(7,990 )	1,173	(40,482 )	(19,010 )	(59,492 )
	Nine Months Ended September 30, 2012					
	Healthcare	Technology	Penn Mezzanine	Total Segments	Other Items	Total
	(In thousands)					
	(Unaudited)					
Operating loss	\$—	\$—	\$(6 )	\$(6 )	\$(14,675 )	\$(14,681 )
Interest income	—	—	1,170	1,170	1,020	2,190
Equity income (loss)	(20,886 )	1,463	(260 )	(19,683 )	(5 )	(19,688 )
Net income (loss)	(11,991 )	1,463	340	(10,188 )	(18,366 )	(28,554 )

## 10. Commitments and Contingencies

The Company and its partner companies are involved in various claims and legal actions arising in the ordinary course of business. While in the current opinion of the Company the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position or results of operations, no assurance can be given as to the outcome of these actions, and one or more adverse rulings could have a material adverse effect on the Company's consolidated financial position and results of operations or that of its partner companies. The Company records costs associated with legal fees as such services are rendered.

The Company had outstanding guarantees of \$3.8 million at September 30, 2013.

The Company has committed capital of approximately \$0.1 million to a private equity fund. This commitment is expected to be funded during the next 12 months.

Under certain circumstances, the Company may be required to return a portion or all the distributions it received as a general partner of a private equity fund ("clawback"). The maximum clawback the Company could be required to return due to its general partner interest is approximately \$1.3 million, of which \$1.0 million was reflected in Accrued expenses and other current liabilities and \$0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2013. The Company's ownership in the fund is 19%. The clawback liability is joint and several; therefore the Company may be required to fund the clawback for other general partners should they default. The Company believes its potential liability due to the possibility of default by other general partners is remote.

In connection with the Company's May 2008 sale of its equity and debt interests in Acsis, Inc., Alliance Consulting Group Associates, Inc., Laureate Biopharma, Inc., ProModel Corporation and Neuronix, Inc. (the "Bundle Transaction"), an aggregate of \$6.4 million of the gross proceeds of the sale were placed in escrow pending the expiration of a predetermined notification period, subject to possible extension in the event of a claim against the escrowed amounts. On April 25, 2009, the purchaser in the Bundle Transaction notified the Company of claims being asserted against the entire escrowed amounts. In April 2013, the case was tried on the merits and the verdict in the case denied the purchaser's claims against the escrowed funds. The escrow funds were released to the Company in June 2013.

In connection with the Bundle Transaction, the Company agreed to continue its guarantee of the Laureate Biopharma, Inc. Princeton, New Jersey facility lease, subject to certain conditions. During the three months ended September 30, 2013, the Company obtained the release of its obligation at no expense to the Company.

In October 2001, the Company entered into an agreement with its former Chairman and Chief Executive Officer to provide for annual payments of \$0.65 million per year and certain health care and other benefits for life. The related current liability of \$0.8 million was included in Accrued expenses and other current liabilities and the long-term portion of \$2.7 million was included in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2013.

The Company provided a \$6.3 million letter of credit expiring on March 19, 2019 to the landlord of CompuCom Systems, Inc.'s Dallas headquarters as required in connection with the sale of CompuCom Systems in 2004.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company has agreements with certain employees that provide for severance payments to the employee in the event the employee is terminated without cause or an employee terminates his employment for “good reason.” The maximum aggregate exposure under the agreements was approximately \$2.4 million at September 30, 2013. During the second quarter of 2013, a Company executive terminated his employment for “good reason.” As a result of the termination, the Company recognized a severance charge of \$0.9 million. During the three months ended September 30, 2013, substantially all the payments required to be made by the Company related to the severance charge were paid.

19

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

### Cautionary Note Concerning Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about Safeguard Scientifics, Inc. ("Safeguard" or "we"), the industries in which we operate and other matters, as well as management's beliefs and assumptions and other statements regarding matters that are not historical facts. These statements include, in particular, statements about our plans, strategies and prospects. For example, when we use words such as "projects," "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "should," "would," "could," "will," "opportunity," "potential" or "may," variations of such words or other words to convey uncertainty of future events or outcomes, we are making forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Our forward-looking statements are subject to risks and uncertainties. Factors that could cause actual results to differ materially, include, among others, our ability to make good decisions about the deployment of capital, the fact that our partner companies may vary from period to period, our substantial capital requirements and absence of liquidity from our partner company holdings, fluctuations in the market prices of our publicly traded partner company holdings, competition, our inability to obtain maximum value for our partner company holdings, our ability to attract and retain qualified employees, our ability to execute our strategy, market valuations in sectors in which our partner companies operate, our inability to control our partner companies, our need to manage our assets to avoid registration under the Investment Company Act of 1940, and risks associated with our partner companies, including the fact that most of our partner companies have a limited history and a history of operating losses, face intense competition and may never be profitable, the effect of economic conditions in the business sectors in which Safeguard's partner companies operate, compliance with government regulation and legal liabilities, all of which are discussed in Item 1A. "Risk Factors" in Safeguard's Annual Report on Form 10-K and updated, as applicable, in "Factors that May Affect Future Results" and Item 1A. "Risk Factors" below. Many of these factors are beyond our ability to predict or control. In addition, as a result of these and other factors, our past financial performance should not be relied on as an indication of future performance. All forward-looking statements attributable to us, or to persons acting on our behalf, are expressly qualified in their entirety by this cautionary statement. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report might not occur.

### Business Overview

Safeguard's charter is to build value in growth-stage businesses by providing capital as well as strategic, operational and management resources. Safeguard participates in expansion financings, corporate spin-outs, buyouts, recapitalizations, industry consolidations and early-stage financings. Our vision is to be the preferred catalyst to build great companies across diverse capital platforms.

We strive to create long-term value for our shareholders by helping partner companies increase their market penetration, grow revenue and improve cash flow. Safeguard focuses principally on companies with initial capital requirements between \$5 million and \$15 million, and follow-on financings between \$5 million and \$10 million, with a total anticipated deployment of up to \$25 million from Safeguard. In addition, Safeguard principally targets companies that operate in two sectors:

Healthcare — companies focused on medical technology ("MedTech"), including diagnostics and devices; healthcare technology ("HealthTech"); and specialty pharmaceuticals. Within these areas, Safeguard targets companies that have lesser regulatory risk and have achieved or are near commercialization; and

Technology — companies focused on digital media; financial technology ("FinTech"); and Enterprise 3.0, which includes mobile technology, cloud, the "Internet of Things" and big data. Within these areas, Safeguard targets companies that have transaction-enabling applications with a recurring revenue stream.

### Principles of Accounting for Ownership Interests in Partner Companies

We account for our interests in our partner companies and private equity funds using one of the following methods: consolidation, fair value, equity, cost or available-for-sale. The accounting method applied is generally determined by the degree of our influence over the entity, primarily determined by our voting interest in the entity.

Consolidation Method. We account for partner companies in which we maintain a controlling financial interest, generally those in which we directly or indirectly own more than 50% of the outstanding voting securities, using the consolidation method of accounting. Upon consolidation of our partner companies, we reflect the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to the parent company as a non-controlling interest in the Consolidated Balance Sheets. The non-controlling interest is presented within equity, separately from the equity of the parent company. Losses attributable to the parent company and the non-controlling interest may exceed their interest in the subsidiary's equity. As a result, the non-controlling interest shall continue to be attributed its share of losses even if that attribution results in a deficit non-controlling



interest balance as of each balance sheet date. Revenue, expenses, gains, losses, and net income or loss are reported in the Consolidated Statements of Operations at the consolidated amounts, which include the amounts attributable to the parent company's common shareholders and the non-controlling interest. As of September 30, 2013, we did not hold a controlling interest in any of our partner companies.

**Fair Value Method.** We account for our holdings in NuPathe, a publicly traded partner company, under the fair value method of accounting. Unrealized gains and losses on the mark-to-market of our holdings in fair value method companies and realized gains and losses on the sale of any holdings in fair value method companies are recognized in Other income (loss), net in the Consolidated Statements of Operations.

**Equity Method.** We account for partner companies whose results are not consolidated, but over whom we exercise significant influence, using the equity method of accounting. We also account for our interests in some private equity funds under the equity method of accounting, based on our non-controlling general and limited partner interests.

Under the equity method of accounting, our share of the income or loss of the partner company is reflected in Equity income (loss) in the Consolidated Statements of Operations. We report our share of the income or loss of the equity method partner companies on a one quarter lag. We include the carrying value of equity method partner companies in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

When the carrying value of our holdings in an equity method partner company is reduced to zero, no further losses are recorded in our Consolidated Statements of Operations unless we have outstanding guarantee obligations or have committed additional funding to the equity method partner company. When the equity method partner company subsequently reports income, we will not record our share of such income until it equals the amount of our share of losses not previously recognized.

**Cost Method.** We account for partner companies which are not consolidated or accounted for under the equity method or fair value method under the cost method of accounting. Under the cost method, our share of the income or losses of such partner companies is not included in our Consolidated Statements of Operations. We include the carrying value of cost method partner companies in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

**Available-for-Sale Securities.** We account for our ownership interest in Tengion, Inc. as available-for-sale securities. Available-for-sale securities are carried at fair value, based on quoted market prices, with the unrealized gains and losses, net of tax, reported as a separate component of equity. Unrealized losses are charged against net income (loss) when a decline in the fair value is determined to be other than temporary.

#### Critical Accounting Policies and Estimates

Accounting policies, methods and estimates are an integral part of the Consolidated Financial Statements prepared by management and are based upon management's current judgments. These judgments are normally based on knowledge and experience with regard to past and current events and assumptions about future events. Certain accounting policies, methods and estimates are particularly important because of their significance to the financial statements and because of the possibility that future events affecting them may differ from management's current judgments. While there are a number of accounting policies, methods and estimates affecting our financial statements, areas that are particularly significant include the following:

- 1 Impairment of ownership interests in and advances to partner companies and funds;
- 2 Accounting for participating interests in mezzanine loans receivable and related equity interests;
- 3 Income taxes;
- 4 Commitments and contingencies; and
- 5 Stock-based compensation.

#### Impairment of Ownership Interests In and Advances to Partner Companies and Funds

On a periodic basis, but no less frequently than at the end of each quarter, we evaluate the carrying value of our equity and cost method partner companies and available-for-sale securities for possible impairment based on achievement of business plan objectives and milestones, the financial condition and prospects of the company, market conditions and other relevant factors. The business plan objectives and milestones we consider include, among others, those related to financial performance, such as achievement of planned financial results or completion of capital raising activities, and those that are not primarily financial in nature, such as hiring of key employees or the establishment of strategic relationships. We then determine whether there has been an other than temporary decline in the value of our

ownership interest in the company. For our equity and cost method partner companies, impairment to be recognized is measured as the amount by which the carrying value of the asset exceeds its fair value. The adjusted carrying value of a partner company is not increased if circumstances suggest the value of the partner company has subsequently recovered.

The fair value of privately held partner companies is generally determined based on the value at which independent third parties have invested or have committed to invest in these companies, or based on other valuation methods including discounted cash flows, valuations of comparable public companies and valuations of acquisitions of comparable companies. The fair value of our ownership interests in private equity funds is generally determined based on the value of our pro rata portion of the funds' net assets and estimated future proceeds from sales of investments provided by the funds' managers. The fair value of our ownership interests in our publicly traded partner companies is determined by reference to quoted prices in an active market for the partner company's publicly traded common stock. Our partner companies operate in industries which are rapidly evolving and extremely competitive. It is reasonably possible that our accounting estimates with respect to the ultimate recoverability of the carrying value of ownership interests in and advances to partner companies and funds could change in the near term and that the effect of such changes on our Consolidated Financial Statements could be material. While we believe that the current recorded carrying values of our equity and cost method partner companies and available-for-sale securities are not impaired, there can be no assurance that our future results will confirm this assessment or that a significant write-down or write-off will not be required in the future.

Impairment charges related to equity method partner companies are included in Equity income (loss) in the Consolidated Statements of Operations. Impairment charges related to cost method and available-for-sale partner companies are included in Other income (loss), net in the Consolidated Statements of Operations.

#### Accounting for Participating Interests in Mezzanine Loans Receivable and Related Equity Interests

Through our relationship with Penn Mezzanine, we may acquire participating interests in mezzanine loans and related equity interests of the borrowers. These interests may also include warrants to purchase common stock of the borrowers. Our accounting policies for these participating interests are as follows:

#### Loan Participations Receivable

Our participating interests in Penn Mezzanine loans are included in Loan participations receivable on the Consolidated Balance Sheets. In connection with each financing transaction, Penn Mezzanine assesses the credit worthiness of the borrower through various standard industry metrics including leverage ratios, working capital metrics, cash flow projections and an overall evaluation of the borrower's business model. We use these analyses in making our determination to participate in any funding.

On a quarterly basis, we evaluate the carrying value of each loan participation receivable for impairment. A loan participation receivable is considered impaired when it is probable that we will be unable to collect all amounts (principal and interest) due according to the contractual terms of the participation agreement and related agreements with the borrowers. We maintain an allowance to provide for estimated loan losses based on evaluating known and inherent risks in the loans. The allowance is provided based upon our analysis of the pertinent factors underlying the quality of the loans. These factors include an analysis of the financial condition of the borrowers, delinquency levels, actual loan loss experience, current economic conditions and other relevant factors. Our analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. We do not accrue interest when a loan is considered impaired. All cash receipts from impaired loans are applied to reduce the original principal amount of such loan, until the principal has been fully recovered and would be recognized as interest income thereafter. The allowance for loan losses was \$2.3 million and \$2.0 million as of September 30, 2013 and December 31, 2012, respectively.

#### Equity Participations

Our participation in equity interests acquired by Penn Mezzanine is accounted for under the cost method of accounting. On a quarterly basis, we evaluate the carrying value of our participation in these equity interests for possible impairment based on achievement of business plan objectives and milestones, the fair value of the equity interest relative to its carrying value, the financial condition and prospects of the underlying company and other relevant factors. Our participating interest in equity interests acquired by Penn Mezzanine is included in Other assets on the Consolidated Balance Sheets.

#### Warrant Participations

We recognize our participation in warrants acquired by Penn Mezzanine based on the fair value of the warrants at the balance sheet date. The fair values of warrant participations are bifurcated from the related loan participations receivable based on the relative fair value of the respective instruments at the acquisition date. Any gain or loss

associated with changes in the fair value of the warrants at the balance sheet date is recorded in Other income (loss), net in the Consolidated Statements of Operations. The fair value of the warrants is included in Other assets on the Consolidated Balance Sheets.

**Income Taxes**

We are required to estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of

items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our Consolidated Balance Sheets. We must assess the likelihood that the deferred tax assets will be recovered from future taxable income and to the extent that we believe recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance in a period, we must include an expense within the tax provision in the Consolidated Statements of Operations. We have recorded a valuation allowance to reduce our deferred tax assets to an amount that is more likely than not to be realized in future years. If we determine in the future that it is more likely than not that the net deferred tax assets would be realized, then the previously provided valuation allowance would be reversed.

#### Commitments and Contingencies

From time to time, we are a defendant or plaintiff in various legal actions which arise in the normal course of business. Additionally, we have received distributions as both a general partner and a limited partner from private equity funds. In certain circumstances, we may be required to return a portion or all the distributions we received as a general partner of a fund for a further distribution to such fund's limited partners ("clawback"). We are also a guarantor of various third-party obligations and commitments and are subject to the possibility of various loss contingencies arising in the ordinary course of business (see Note 10). We are required to assess the likelihood of any adverse outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of provision required for these commitments and contingencies, if any, which would be charged to earnings, is made after careful analysis of each matter. The provision may change in the future due to new developments or changes in circumstances. Changes in the provision could increase or decrease our earnings in the period the changes are made.

#### Stock-Based Compensation

We measure all employee stock-based compensation awards using a fair value method and record such expense in our Consolidated Statements of Operations.

We estimate the grant date fair value of stock options using the Black-Scholes option-pricing model which requires the input of various assumptions. These assumptions include estimating the expected term of the award and the estimated volatility of our stock price over the expected term. Changes in these assumptions and in the estimated forfeitures of stock option awards can materially affect the amount of stock-based compensation recognized in the Consolidated Statements of Operations. The requisite service periods for market-based stock option awards are based on our estimate of the dates on which the market conditions will be met as determined using a Monte Carlo simulation model. Changes in the derived requisite service period or achievement of market capitalization targets earlier than estimated can materially affect the amount of stock-based compensation recognized in the Consolidated Statements of Operations in any one period. The requisite service periods for performance-based awards are based on our best estimate of when the performance conditions will be met. Compensation expense is recognized for performance-based awards for which the performance condition is considered probable of achievement. Changes in the requisite service period or the estimated probability of achievement of performance conditions can materially affect the amount of stock-based compensation recognized in the Consolidated Statements of Operations in any one period.

#### Results of Operations

Our reportable operating segments are Healthcare, Technology and Penn Mezzanine. In the fourth quarter of 2012, we expanded our focus within the former Life Sciences segment to include companies in the HealthTech sector and renamed that segment "Healthcare." The HealthTech sector had previously been included in our Technology segment.

AdvantEdge Healthcare Solutions, a provider of physician billing and practice management services and software, which had previously been reported within the Technology segment, is now reported under the Healthcare segment. As a result of the change, we have restated our previously reported segment disclosure information, to include the results of AdvantEdge Healthcare Solutions within the Healthcare segment.

The results of operations of all of our partner companies are reported in our Healthcare and Technology segments.

The Healthcare and Technology segments also include the gain or loss on the sale of respective partner companies. Our management evaluates the Healthcare and Technology segments' performance based on net income (loss) which is impacted by the number of partner companies accounted for under the equity method, our voting ownership percentage in these partner companies and the net results of operations of these partner companies, any impairment charges and gain (loss) on the sale of equity and cost method partner companies.

Our management evaluates the Penn Mezzanine segment performance based on the performance of the debt and equity interests in which we participate. This includes an evaluation of the future cash flows associated interest and dividend payments as well as estimated losses based on evaluating known and inherent risks in the debt and equity interests in which we participate.

23

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Other items include certain expenses, which are not identifiable to the operations of our operating business segments. Other items primarily consist of general and administrative expenses related to corporate operations, including employee compensation, insurance and professional fees, interest income, interest expense, and other income (loss) and equity income (loss) related to private equity holdings. Other items also include income taxes, which are reviewed by management independent of segment results.

The following tables reflect our consolidated operating data by reportable segment. Segment results include our share of income or losses for entities accounted for under the equity method, when applicable. Segment results also include impairment charges and gains or losses related to the disposition of partner companies. All significant inter-segment activity has been eliminated in consolidation. Our operating results, including net income (loss) before income taxes by segment, were as follows:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	2013	2012	2013	2012
	(In thousands)			
Healthcare	\$ (11,325	) \$ (5,811	) \$ (33,665	) \$ (11,991
Technology	(3,490	) 2,508	(7,990	) 1,463
Penn Mezzanine	845	423	1,173	340
Total segments	(13,970	) (2,880	) (40,482	) (10,188
Other items:				
Corporate operations	(5,460	) (5,877	) (19,010	) (18,366
Income tax benefit (expense)	—	—	—	—
Total other items	(5,460	) (5,877	) (19,010	) (18,366
Net loss	\$ (19,430	) \$ (8,757	) \$ (59,492	) \$ (28,554

There is intense competition in the markets in which our partner companies operate, and we expect competition to intensify in the future. Additionally, the markets in which these companies operate are characterized by rapidly changing technology, evolving industry standards, frequent introduction of new products and services, shifting distribution channels, evolving government regulation, frequently changing intellectual property landscapes and changing customer demands. Their future success depends on each company's ability to execute its business plan and to adapt to its respective rapidly changing markets.

As previously stated, throughout this document, we use the term "partner company" to generally refer to those companies in which we have an economic interest and in which we are actively involved in influencing the development, usually through board representation in addition to our equity ownership.

For purposes of the following listing of our Healthcare and Technology partner companies, we omit from the listing companies in which we have since sold our interest or which we no longer consider to be active partner companies because we no longer actively influence the operations of such entities.

Healthcare

The following active partner companies as of September 30, 2013 were included in Healthcare:

Partner Company	Safeguard Primary Ownership as of		Accounting Method
	September 30, 2013	September 30, 2012	
AdvantEdge Healthcare Solutions, Inc.	40.2%	40.2%	Equity
Alverix, Inc.	49.2%	49.2%	Equity
Crescendo Bioscience, Inc.	12.6%	NA	Cost
Good Start Genetics, Inc.	30.0%	29.2%	Equity
Medivo, Inc.	34.5%	30.0%	Equity
NovaSom, Inc.	30.3%	30.3%	Equity
NuPathe Inc.	16.5%	17.8%	Fair value (1)
PixelOptics, Inc.	24.6%	24.6%	Equity
Putney, Inc.	27.6%	27.6%	Equity
Quantia, Inc.	34.4%	NA	Equity
Sotera Wireless, Inc.	7.4%	NA	Cost

(1) Our ownership interest in NuPathe was accounted for as available-for-sale securities following NuPathe's completion of an initial public offering in August 2010. In October 2012, we participated in a private placement of NuPathe preferred stock units, and in conjunction with this financing, we placed two persons on NuPathe's board of directors. As a result, we determined that we exercised significant influence over NuPathe which made the equity method of accounting applicable to our ownership interests. Instead, we elected the fair value option beginning in October 2012. Prior to August 2010, we accounted for NuPathe under the equity method.

Results of operations for the Healthcare segment were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
Other income (loss), net	\$ (4,772 )	\$ (84 )	\$ (6,362 )	\$ 8,895 )
Equity loss	(6,553 )	(5,727 )	(27,303 )	(20,886 )
Net loss	\$ (11,325 )	\$ (5,811 )	\$ (33,665 )	\$ (11,991 )

Three months ended September 30, 2013 versus the three months ended September 30, 2012

Other Income (Loss), Net. Other income (loss), net increased \$4.7 million for the three months ended September 30, 2013, compared to the prior year period. Other income (loss), net for the three months ended September 30, 2013 reflected an unrealized loss of \$4.8 million on the mark-to-market of our holdings in NuPathe. Other income (loss), net for the three months ended September 30, 2012 reflected a \$0.1 million impairment charge on our holdings in Tengion, Inc. ("Tengion").

Equity Loss. Equity loss fluctuates with the number of Healthcare partner companies accounted for under the equity method, our voting ownership percentage in these partner companies and the net results of operations of these partner companies. We recognize our share of losses to the extent we have cost basis in the equity partner company or outstanding commitments or guarantees. Certain amounts recorded to reflect our share of the income or losses of our partner companies accounted for under the equity method are based on estimates and on unaudited results of operations of those partner companies and may require adjustments in the future when audits of these entities are made final. We report our share of the results of our equity method partner companies on a one quarter lag basis. Equity loss for the Healthcare segment increased \$0.8 million in the three months ended September 30, 2013 compared to the prior year period. The increase in equity loss was primarily driven by an impairment charge of \$1.3 million related to PixelOptics which was recognized in the three months ended September 30, 2013. The impairment recognized in the third quarter of 2013 was based on PixelOptics' inability to raise additional capital from independent sources to continue its operations. The increase was partially offset by smaller losses incurred by partner companies in the Healthcare segment in the three months ended September 30, 2013 as compared to the three months ended



September 30, 2012.

25

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Nine months ended September 30, 2013 versus the nine months ended September 30, 2012

Other Income (Loss), Net. Other income (loss), net decreased \$15.3 million for the nine months ended September 30, 2013, compared to the prior year period. Other income (loss), net for the nine months ended September 30, 2013 reflected an unrealized loss of \$6.4 million related to the mark-to-market of our holdings in NuPathe. Other income (loss), net for the nine months ended September 30, 2012 reflected a \$3.4 million gain recorded in connection with the expiration of the escrow period associated with the sale of Avid to Eli Lilly and Company in December 2010, as well as a \$5.6 million gain related to the achievement of the initial milestone associated with the Avid transaction. These gains were partially offset by an impairment charge of \$0.2 million on our holdings in Tengion.

Equity Loss. Equity loss for the Healthcare segment increased \$6.4 million in the nine months ended September 30, 2013 compared to the prior year period. The increase in equity loss was primarily driven by an impairment charge of \$11.2 million related to PixelOptics which was recognized in the nine months ended September 30, 2013. The impairment charges in 2013 were based on our decision to deploy no substantial additional capital in PixelOptics and PixelOptics' inability to raise additional capital from independent sources to continue its operations. We recognized an impairment charge of \$3.7 million related to PixelOptics in the nine months ended September 30, 2012. The impairment in 2012 was related to launch delays and related supply chain issues as well as the pricing of a transaction between other institutional shareholders in PixelOptics. The net increase in impairment charges was partially offset by smaller losses incurred by partner companies in the Healthcare segment in the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012.

Technology

The following active partner companies as of September 30, 2013 were included in Technology:

Partner Company	Safeguard Primary Ownership as of		Accounting Method
	September 30,		
	2013	2012	
AppFirst, Inc.	34.5%	NA	Equity
Beyond.com, Inc.	38.2%	38.3%	Equity
Bridgevine, Inc.	22.7%	21.7%	Equity
Clutch Holdings, Inc.	24.0%	NA	Equity
DriveFactor, Inc.	40.6%	23.9%	Equity
Hoopla Software, Inc.	25.3%	25.3%	Equity
Lumesis, Inc.	44.2%	31.6%	Equity
MediaMath, Inc.	22.5%	22.4%	Equity
Pneuron Corporation	27.6%	NA	Equity
Spongecell, Inc.	23.0%	23.1%	Equity
ThingWorx, Inc.	39.8%	44.0%	Equity

Results of operations for the Technology segment were as follows:

	Three Months Ended September		Nine Months Ended September	
	30,		30,	
	2013	2012	2013	2012
	(In thousands)			
Equity income (loss)	\$(3,490)	) \$2,508	\$(7,990)	) \$1,463
Net income (loss)	\$(3,490)	) \$2,508	\$(7,990)	) \$1,463

Three months ended September 30, 2013 versus the three months ended September 30, 2012

Equity Income (Loss). Equity income (loss) fluctuates with the number of Technology partner companies accounted for under the equity method, our voting ownership percentage in these partner companies and the net results of operations of these partner companies. We recognize our share of losses to the extent we have cost basis in the equity partner company or outstanding commitments or guarantees. Certain amounts recorded to reflect our share of the income or losses of our partner companies accounted for under the equity method are based on estimates and on unaudited results of operations of those partner companies and may require adjustments in the future when audits of these entities are made final. We report our share of the results of our equity method partner companies on a one

quarter lag.

26

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Equity income (loss) for the Technology segment decreased \$6.0 million in the three months ended September 30, 2013, compared to the prior year period. Equity income (loss) for the three months ended September 30, 2012 included a \$3.4 million gain recorded in connection with the expiration of the escrow period associated with the sale of Portico Systems, Inc. ("Portico"). The three months ended September 30, 2012 also included a gain of \$0.6 million related to a payment received upon the liquidation of SafeCentral, Inc. ("SafeCentral"), a former equity method partner company. The remainder of the decrease for the three months ended September 30, 2013 compared to the prior year period was primarily related to an increase in the number of partner companies and losses associated with those partner companies included within the Technology segment.

Nine months ended September 30, 2013 versus the nine months ended September 30, 2012

Equity Income (Loss). Equity income (loss) for the Technology segment decreased \$9.5 million in the nine months ended September 30, 2013, compared to the prior year period. The decrease primarily related to the recognition of gains of \$3.4 million and \$1.9 million associated with the receipt of the escrowed proceeds and the achievement of performance milestones related to the Portico transaction in the nine months ended September 30, 2012. The nine months ended September 30, 2012 also included a gain of \$0.6 million related to a payment received upon the liquidation of SafeCentral, a former equity method partner company. The remainder of the decrease for the nine months ended September 30, 2013 compared to the prior year period was primarily related to an increase in the number of partner companies and losses associated with those partner companies included within the Technology segment.

#### Penn Mezzanine

Results for the Penn Mezzanine segment were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
General and administrative expense	\$ (4)	\$ (2)	\$ (13)	\$ (6)
Interest income	394	322	1,118	1,170
Other income (loss), net	547	175	324	(564)
Equity loss	(92)	(72)	(256)	(260)
Net income	\$ 845	\$ 423	\$ 1,173	\$ 340

Results of the Penn Mezzanine segment include interest, dividends, loan origination and other fees earned on the mezzanine interests in which we participate, any impairment on our debt and equity interests as well as equity income (loss) associated with our interest in the management company and general partner of Penn Mezzanine. As of September 30, 2013, we had a participation in eight loans and eight equity interests initiated by Penn Mezzanine.

During the nine months ended September 30, 2013, we participated in follow on funding of an existing mezzanine loan for \$0.2 million and one new mezzanine loan for \$2.1 million.

Three months ended September 30, 2013 versus the three months ended September 30, 2012

Other Income (Loss), Net. Other income (loss), net for Penn Mezzanine increased \$0.4 million in the three months ended September 30, 2013 compared to the prior year period. During the three months ended September 30, 2013, we recorded a gain on the sale of one of our Penn Mezzanine equity interests of \$0.5 million. During the three months ended September 30, 2012, we recorded a gain of \$0.2 million associated with mark-to-market adjustments related to our warrant participations in Penn Mezzanine. General and administrative expense, interest income, and equity loss remained consistent in the current year period compared to the prior year period.

Nine months ended September 30, 2013 versus the nine months ended September 30, 2012

Other Income (Loss), Net. Other income (loss), net for Penn Mezzanine increased \$0.9 million in the nine months ended September 30, 2013 compared to the prior year period. During the nine months ended September 30, 2013, we recorded a gain on the sale of one of our Penn Mezzanine equity interests of \$0.5 million. The increase was partially offset by an impairment charge associated with our equity and loan participations of \$0.3 million recognized in the nine months ended September 30, 2013. During the nine months ended September 30, 2012, we recorded a gain of \$0.2 million associated with mark-to-market adjustments related to our warrant participations in Penn Mezzanine. The gain was offset by an impairment charge associated with our equity and loan participations of \$0.7 million recognized

in the nine months ended September 30, 2012. General and administrative expense, interest income, and equity loss remained relatively consistent in the current year period compared to the prior year period.

## Corporate Operations

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
General and administrative expense	\$ (4,301	) \$ (4,453	) \$ (15,033	) \$ (13,051
Stock-based compensation	(510	) (317	) (1,808	) (1,546
Depreciation	(20	) (18	) (70	) (78
Interest income	178	374	978	1,020
Interest expense	(1,077	) (1,461	) (3,220	) (4,369
Other income (loss), net	1	—	(153	) (337
Equity income (loss)	269	(2	) 296	(5
	\$ (5,460	) \$ (5,877	) \$ (19,010	) \$ (18,366

Three months ended September 30, 2013 versus the three months ended September 30, 2012

**General and Administrative Expense.** Our general and administrative expenses consist primarily of employee compensation, insurance, travel-related costs, office rent and professional services such as consulting, legal, and accounting. General and administrative expense decreased \$0.2 million in the three months ended September 30, 2013 when compared to the prior year period. The decrease was primarily attributable to a decrease in professional fees of \$0.5 million in addition to a decrease in employee costs of \$0.2 million. These decreases were partially offset by a \$0.4 million increase in costs associated with a transitional services agreement with our previous Chief Executive Officer.

**Stock-Based Compensation.** Stock-based compensation consists primarily of expense related to stock option grants and grants of restricted stock and deferred stock units to our employees. Stock-based compensation increased \$0.2 million in the three months ended September 30, 2013 when compared to the prior year period. The increase is primarily attributable to an increase in expense related to restricted stock awards of \$0.1 million and an increase in expense related to performance-based awards of \$0.1 million.

**Interest Income.** Interest income includes all interest earned on available cash and marketable security balances. The decrease of \$0.2 million in the three months ended September 30, 2013 was primarily attributable to lower average cash and marketable security balances compared to the prior year period.

**Interest Expense.** Interest expense is primarily related to our convertible senior debentures. The decrease in interest expense of \$0.4 million in the three months ended September 30, 2013 compared to the prior year period is due to a lower coupon rate of 5.25% payable on our 2018 Debentures compared to a coupon rate of 10.125% payable on our 2014 Debentures, which were substantially repaid in November 2012.

**Equity Income (Loss).** Equity income (loss) for both periods related to our private equity holdings accounted for under the equity method. The increase of \$0.3 million in the three months ended September 30, 2013 was primarily attributable to a \$0.3 million distribution from one of our private equity holdings.

Nine months ended September 30, 2013 versus the nine months ended September 30, 2012

**General and Administrative Expense.** General and administrative expense increased \$2.0 million in the nine months ended September 30, 2013 when compared to the prior year period. The increase was primarily attributable to a \$1.2 million increase in costs associated with a transitional services agreement with our previous Chief Executive Officer and severance expense of \$0.9 million recorded during the nine months ended September 30, 2013 related to a former executive. Professional fees also increased \$0.4 million when compared to the prior year period. These increases in expense were partially offset by a decrease in employee costs of \$0.9 million.

**Stock-Based Compensation.** Stock-based compensation consists primarily of expense related to stock option grants and grants of restricted stock and deferred stock units to our employees. Stock-based compensation increased \$0.3 million in the nine months ended September 30, 2013 when compared to the prior year period. The increase is primarily attributable to an increase in expense related to restricted stock awards of \$0.3 million and an increase in expense related to performance based awards of \$0.2 million, partially offset by a decrease in expense related to

market-based awards of \$0.2 million.

**Interest Income.** Interest income includes all interest earned on available cash and marketable security balances.

Interest income remained consistent for the nine months ended September 30, 2013 compared to the prior year period.

**Interest Expense.** Interest expense is primarily related to our convertible senior debentures. The decrease in interest expense of \$1.1 million in the nine months ended September 30, 2013 compared to the prior year period is due to a lower coupon rate of 5.25% payable on our 2018 Debentures compared to a coupon rate of 10.125% payable on our 2014 Debentures, which were substantially repaid in November 2012.

**Other Income (Loss), Net.** Other income (loss), net decreased \$0.2 million for the nine months ended September 30, 2013, compared to the prior year period. Other income (loss), net for the nine months ended September 30, 2013 and 2012 includes impairment charges of \$0.2 million and \$0.4 million, respectively, related to our interest in a legacy private equity fund.

**Equity Income (Loss).** Equity income (loss) for both periods related to our private equity holdings accounted for under the equity method. The increase of \$0.3 million in the nine months ended September 30, 2013 was primarily attributable to a \$0.3 million distribution from one of our private equity holdings.

**Income Tax Expense (Benefit)**

Income tax expense (benefit) for the three and nine months ended September 30, 2013 and 2012 was \$0. We have recorded a valuation allowance to reduce our net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the benefit of the net operating loss that would have been recognized in each period was offset by a valuation allowance.

**Liquidity and Capital Resources**

We fund our operations with cash on hand as well as proceeds from sales of and distributions from partner companies, private equity funds and marketable securities. In prior periods, we have also used sales of our equity and issuance of debt as sources of liquidity and may do so in the future. Our ability to generate liquidity from sales of our partner company interests, sales of marketable securities and from equity and debt issuances has been adversely affected from time to time by adverse circumstances in the U.S. capital markets and other factors.

As of September 30, 2013, we had \$108.7 million of cash and cash equivalents and \$57.4 million of short-term and long-term marketable securities for a total of \$166.1 million.

We have not recognized on our Consolidated Balance Sheets \$7.6 million held in escrow related to the sale of Advanced BioHealing, Inc. to Shire plc in June 2011. Prior to the expiration of the escrow period in March 2012, Shire plc filed a claim against the escrowed funds. No further proceeds will be distributed to us or other former owners until the validity of such claims is determined.

In April 2012, we received \$3.4 million in connection with the expiration of the escrow period associated with the sale of Avid Radiopharmaceuticals, Inc. (“Avid”) to Eli Lilly and Company in December 2010. Also in April 2012, a regulatory milestone associated with the Avid transaction was achieved which resulted in \$5.6 million of additional proceeds being paid to us in the second quarter of 2012. In addition, depending on the achievement of certain difficult commercial and regulatory milestones, we could receive additional proceeds of up to \$54.0 million over a six-year period. We presently view it as unlikely that we will receive any significant portion of such amount in the short or long-term.

In connection with the May 2008 sale of our equity and debt interests in Acasis, Inc., Alliance Consulting Group Associates, Inc., Laureate Biopharma, Inc., ProModel Corporation and Neuronix, Inc. (the “Bundle Transaction”), an aggregate of \$6.4 million of the gross proceeds of the sale were placed in escrow pending the expiration of a predetermined notification period, subject to possible extension in the event of a claim against the escrowed amounts. On April 25, 2009, the purchaser in the Bundle Transaction notified us of claims being asserted against the entire escrowed amounts. In April 2013, the case was tried on the merits and the verdict in the case denied the purchaser’s claims against the escrowed funds. The \$6.4 million in escrow was subsequently released to us in June 2013.

We have outstanding \$55.0 million in face amount of our 5.25% convertible senior debentures due 2018. Net proceeds from the issuance of the 2018 Debentures in November 2012 were used to repurchase substantially all of our 2014 Debentures. Interest on the 2018 Debentures is payable semi-annually. At the debentures holders’ option, the 2018 Debentures are convertible into our common stock prior to November 15, 2017 subject to certain conditions, and at any time after November 15, 2017. The conversion rate of the 2018 Debentures is \$18.13 of principal amount per share. The closing price per share of our common stock at September 30, 2013 was \$15.69. The 2018 Debentures holders have the right to require us to repurchase the 2018 Debentures if we undergo a fundamental change as defined in the debenture agreement, including the sale of all or substantially all of our common stock or assets, liquidation, or



dissolution; a change in control, the delisting of our common stock from the New York Stock Exchange or the NASDAQ Global Market (or any of their respective successors); or a substantial change in the composition of our board of directors as defined in the agreement. On or after November 15, 2016, we may redeem for cash some or all of the debentures, subject to certain conditions. Upon any redemption of the 2018 Debentures,

we will pay a redemption price of 100% of their principal amount, plus accrued and unpaid interest. Upon the conversion of the 2018 Debentures we have the right to settle the conversion in stock, cash or a combination thereof. In addition to the 2018 Debentures discussed above, we had \$0.4 million of 2024 Debentures and \$29 thousand of 2014 Debentures outstanding at September 30, 2013. Interest on the 2024 and 2014 Debentures is payable semi-annually.

In November 2011, our Board of Directors authorized us, from time to time and depending on market conditions, to repurchase shares of our outstanding common stock, with up to an aggregate value of \$10.0 million, exclusive of fees and commissions. No purchases have been made under the authorization through September 30, 2013.

We are party to a loan agreement with a commercial bank which provides us with a revolving credit facility in the maximum aggregate amount of \$50 million in the form of borrowings, guarantees and issuances of letters of credit (subject to a \$20 million sublimit). Actual availability under the credit facility is based on the amount of cash maintained at the bank as well as the value of our public and private partner company interests. This credit facility bears interest at the prime rate for outstanding borrowings, subject to an increase in certain circumstances. Other than for limited exceptions, we are required to maintain all of our depository and operating accounts and the lesser of \$80 million or 75% of our investment and securities accounts at the bank. The credit facility, as amended, matures on December 31, 2014. Under the credit facility, we provided a \$6.3 million letter of credit expiring on March 19, 2019 to the landlord of CompuCom Systems, Inc.'s Dallas headquarters which was required in connection with our sale of CompuCom Systems in 2004. Availability under our revolving credit facility at September 30, 2013 was \$43.7 million.

At September 30, 2013, we had committed capital of approximately \$0.1 million to a private equity fund. This commitment is expected to be funded in the next 12 months.

The transactions we enter into in pursuit of our strategy could increase or decrease our liquidity at any point in time. As we seek to acquire interests in new partner companies, provide additional funding to existing partner companies, or commit capital to other initiatives, we may be required to expend our cash or incur debt, which will decrease our liquidity. Conversely, as we dispose of our interests in partner companies from time to time, we may receive proceeds from such sales, which could increase our liquidity. From time to time, we are engaged in discussions concerning acquisitions and dispositions which, if consummated, could impact our liquidity, perhaps significantly.

Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner of a private equity fund for further distribution to such fund's limited partners ("clawback"). The maximum clawback we could be required to return related to our general partner interest is \$1.3 million, of which \$1.0 million was reflected in Accrued expenses and other current liabilities and \$0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2013. Our ownership in the fund is 19%. The clawback liability is joint and several, such that we may be required to fund the clawback for other general partners should they default. We believe our potential liability due to the possibility of default by other general partners is remote.

For the reasons we have presented above, we believe our cash and cash equivalents at September 30, 2013, availability under our revolving credit facility and other internal sources of cash flow will be sufficient to fund our cash requirements for at least the next 12 months, including debt repayments, commitments to our existing partner companies and funds, possible additional funding of existing partner companies and our general corporate requirements. Our acquisition of new partner company interests is always contingent upon our availability of cash to fund such deployments, and our timing of monetization events directly affects our availability of cash.

#### Analysis of Consolidated Cash Flows

Cash flow activity was as follows:

	Nine Months Ended September 30,	
	2013	2012
	(In thousands)	
Net cash used in operating activities	\$(16,299	) \$(12,616
Net cash provided by (used in) investing activities	54,610	(988
Net cash provided by financing activities	4,354	1,568
	\$42,665	\$(12,036

Net Cash Used In Operating Activities

Net cash used in operating activities increased by \$3.7 million for the nine months ended September 30, 2013 compared to the prior year period. The increase primarily related to a \$0.7 million increase in cash used for professional fees, an increase in cash severance payments of \$0.9 million and an increase in notes receivable from partner companies of \$1.0 million. The

30

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increase also related to \$1.4 million in cash interest payments on our 2018 Debentures. In the prior year period, interest payments were made from a restricted escrow account related to the 2014 Debentures. Interest payments made out of the restricted escrow account on the 2014 Debentures were considered non-cash investing activities. These increases were partially offset by a \$0.7 million decrease in cash used for management incentive plan payments.

**Net Cash Provided by Investing Activities**

Net cash provided by investing activities increased by \$55.6 million for the nine months ended September 30, 2013 compared to the prior year period. The increase primarily related to a \$66.3 million increase in the cash received from the net sale of marketable securities, an increase in proceeds from the sale of discontinued operations of \$6.4 million which related to the release of escrow funds in 2013 and a decrease in advances and loans to companies of \$4.0 million. These increases were partially offset by a \$11.9 million decrease in proceeds from sales of and distributions from partner companies, a decrease in repayments of advances to partner companies of \$2.2 million and an increase in acquisitions of ownership interest in companies and funds of \$7.0 million.

**Net Cash Provided by Financing Activities**

Net cash provided by financing activities increased by \$2.8 million for the nine months ended September 30, 2013 compared to the prior year period. The increase primarily related to the increase in proceeds from the exercise of stock options.

**Contractual Cash Obligations and Other Commercial Commitments**

The following table summarizes our contractual obligations and other commercial commitments as of September 30, 2013 by period due or expiration of the commitment.

	Payments Due by Period				
	Total	Remainder of 2013	2014 and 2015	2016 and 2017	Due after 2017
<b>Contractual Cash Obligations:</b>					
Convertible senior debentures(a)	\$55.5	\$ —	\$0.5	\$—	\$55.0
Operating leases	0.6	0.1	0.5	—	—
Funding commitments(b)	0.1	—	0.1	—	—
Potential clawback liabilities(c)	1.3	1.0	0.3	—	—
Other long-term obligations(d)	3.5	0.2	1.6	1.6	0.1
<b>Total Contractual Cash Obligations</b>	<b>\$61.0</b>	<b>\$ 1.3</b>	<b>\$3.0</b>	<b>\$1.6</b>	<b>\$55.1</b>
<b>Amount of Commitment Expiration by Period</b>					
	<b>Total</b>	<b>Remainder of 2013</b>	<b>2014 and 2015</b>	<b>2016 and 2017</b>	<b>After 2017</b>
<b>Other Commitments:</b>					
Letters of credit(e)	\$6.3	\$ —	\$—	\$—	\$6.3

We have outstanding \$55.0 million of 2018 Debentures with a stated maturity of May 15, 2018, \$0.4 million of 2024 Debentures with a stated maturity of March 15, 2024 and \$29 thousand of 2014 Debentures with a stated maturity of March 15, 2014. The holders of the remaining 2024 Debentures have the right to require the Company to repurchase the remaining 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount, plus accrued and unpaid interest.

(b) This represents a funding commitment to a private equity fund which has been included in 2013 based on estimated timing of capital calls provided to us by the fund's management.

Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner of a private equity fund for a further distribution to such fund's limited partners ("clawback"). The maximum clawback we could be required to return is approximately \$1.3 million, of which \$1.0 million was reflected in Accrued expenses and other current liabilities and \$0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet as of September 30, 2013.

(d) Reflects the estimated amount payable to a former Chairman and CEO under an ongoing agreement.

(e) A \$6.3 million letter of credit is provided to the landlord of CompuCom's Dallas headquarters lease as required in connection with our sale of CompuCom in 2004.



We have agreements with certain employees that provide for severance payments to the employee in the event the employee is terminated without cause or if the employee terminates his employment for “good reason.” The maximum aggregate cash exposure under the agreements was approximately \$2.4 million at September 30, 2013.

In connection with the Bundle Transaction, we agreed to continue our guarantee of the Laureate Biopharma, Inc. Princeton, New Jersey facility lease, subject to certain conditions. During the three months ended September 30, 2013, we obtained the release of our obligation at no expense to us.

As of September 30, 2013, we had federal net operating loss carryforwards totaling approximately \$204.1 million.

The net operating loss carryforwards expire in various amounts from 2021 to 2032.

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the consolidated financial position or results of operations.

#### Factors That May Affect Future Results

You should carefully consider the information set forth below. The following risk factors describe situations in which our business, financial condition and/or results of operations could be materially harmed, and the value of our securities may be adversely affected. You should also refer to other information included or incorporated by reference in this report.

Our principal business depends upon our ability to make good decisions regarding the deployment of capital into new or existing partner companies and, ultimately, the performance of our partner companies, which is uncertain.

If we make poor decisions regarding the deployment of capital into new or existing partner companies, our business model will not succeed. Our success as a company ultimately depends on our ability to choose the right partner companies. If our partner companies do not succeed, the value of our assets could be significantly reduced and require substantial impairments or write-offs and our results of operations and the price of our common stock would be adversely affected. The risks relating to our partner companies include:

- most of our partner companies have a history of operating losses and/or limited operating history;
- the intense competition affecting the products and services our partner companies offer could adversely affect their businesses, financial condition, results of operations and prospects for growth;
- the inability to adapt to changing marketplaces;
- the inability to manage growth;
- the need for additional capital to fund their operations, which we may not be able to fund or which may not be available from third parties on acceptable terms, if at all;
- the inability to protect their proprietary rights and/or infringing on the proprietary rights of others;
- that certain of our partner companies could face legal liabilities from claims made against them based upon their operations, products or work;
- the impact of economic downturns on their operations, results and growth prospects;
- the inability to attract and retain qualified personnel;
- the existence of government regulations and legal uncertainties may place financial burdens on the businesses of our partner companies; and
- the inability to plan for and manage catastrophic events.

These and other risks are discussed in detail under the caption “Risks Related to Our Partner Companies” below.

Our partner companies (and the nature of our interests in them) could vary widely from period to period.

As part of our strategy, we continually assess the value to our shareholders of our interests in our partner companies.

We also regularly evaluate alternative uses for our capital resources. As a result, depending on market conditions, growth prospects and other key factors, we may at any time:

- change the individual and/or types of partner companies on which we focus;
- sell some or all of our interests in any of our partner companies; or
- otherwise change the nature of our interests in our partner companies.

Therefore, the nature of our holdings could vary significantly from period to period.

Our consolidated financial results also may vary significantly based upon which, if any, of our partner companies are included in our Consolidated Financial Statements.

Our business model does not rely upon, or plan for, the receipt of operating cash flows from our partner companies. Our partner companies generally provide us with no cash flow from their operations. We rely on cash on hand, liquidity events and our ability to generate cash from capital raising activities to finance our operations.

We need capital to develop new partner company relationships and to fund the capital needs of our existing partner companies. We also need cash to service and repay our outstanding debt, finance our corporate overhead and meet our existing funding commitments. As a result, we have substantial cash requirements. Our partner companies generally provide us with no cash flow from their operations. To the extent our partner companies generate any cash from operations, they generally retain the funds to develop their own businesses. As a result, we must rely on cash on hand, partner company liquidity events and new capital raising activities to meet our cash needs. If we are unable to find ways of monetizing our holdings or to raise additional capital on attractive terms, we may face liquidity issues that will require us to curtail our new business efforts, constrain our ability to execute our business strategy and limit our ability to provide financial support to our existing partner companies.

Fluctuations in the price of the common stock of our publicly traded holdings may affect the price of our common stock.

Fluctuations in the market prices of the common stock of our publicly traded holdings may affect the price of our common stock. The market prices of our publicly traded holdings have been highly volatile and subject to fluctuations unrelated or disproportionate to operating performance.

Intense competition from other acquirors of interests in companies could result in lower gains or possibly losses on our partner companies.

We face intense competition from other capital providers as we acquire and develop interests in our partner companies. Some of our competitors have more experience identifying, acquiring and selling companies and have greater financial and management resources, brand name recognition or industry contacts than we have. Despite making most of our acquisitions at a stage when our partner companies are not publicly traded, we may still pay higher prices for those equity interests because of higher valuations of similar public companies and competition from other acquirers and capital providers, which could result in lower gains or possibly losses.

We may be unable to obtain maximum value for our holdings or to sell our holdings on a timely basis.

We hold significant positions in our partner companies. Consequently, if we were to divest all or part of our holdings in a partner company, we may have to sell our interests at a relative discount to a price which may be received by a seller of a smaller portion. For partner companies with publicly traded stock, we may be unable to sell our holdings at then-quoted market prices. For instance, the trading volume and public float in the common stock of NuPathe, a publicly traded partner company, is small relative to our holdings. As a result, any significant open-market divestiture by us of our holdings in this partner company, if possible at all, would likely have a material adverse effect on the market price of its common stock and on our proceeds from such a divestiture. Additionally, we may not be able to take our partner companies public as a means of monetizing our position or creating shareholder value.

Registration and other requirements under applicable securities laws may adversely affect our ability to dispose of our holdings on a timely basis.

Our success is dependent on our executive management.

Our success is dependent on our executive management team's ability to execute our strategy. A loss of one or more of the members of our executive management team without adequate replacement could have a material adverse effect on us.

Our business strategy may not be successful if valuations in the market sectors in which our partner companies participate decline.

Our strategy involves creating value for our shareholders by helping our partner companies build value and, if appropriate, accessing the public and private capital markets. Therefore, our success is dependent on the value of our partner companies as determined by the public and private capital markets. Many factors, including reduced market interest, may cause the market value of our partner companies to decline. If valuations in the market sectors in which our partner companies participate decline, their access to the public and private capital markets on terms acceptable to them may be limited.

Our partner companies could make business decisions that are not in our best interests or with which we do not agree, which could impair the value of our holdings.

Although we may seek a controlling or influential equity interest and participation in the management of our partner companies, we may not be able to control the significant business decisions of our partner companies. We may have shared control or no control over some of our partner companies. In addition, although we currently own a significant, influential

33

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interest in some of our partner companies, we do not maintain a controlling interest in any of our partner companies. Acquisitions of interests in partner companies in which we share or have no control, and the dilution of our interests in or loss of control of partner companies, will involve additional risks that could cause the performance of our interests and our operating results to suffer, including:

- the management of a partner company having economic or business interests or objectives that are different from ours; and

- the partner companies not taking our advice with respect to the financial or operating issues they may encounter.

Our inability to control our partner companies also could prevent us from assisting them, financially or otherwise, or could prevent us from liquidating our interests in them at a time or at a price that is favorable to us. Additionally, our partner companies may not act in ways that are consistent with our business strategy. These factors could hamper our ability to maximize returns on our interests and cause us to incur losses on our interests in these partner companies.

We may have to buy, sell or retain assets when we would otherwise not wish to do so in order to avoid registration under the Investment Company Act.

The Investment Company Act of 1940 regulates companies which are engaged primarily in the business of investing, reinvesting, owning, holding or trading in securities. Under the Investment Company Act, a company may be deemed to be an investment company if it owns investment securities with a value exceeding 40% of the value of its total assets (excluding government securities and cash items) on an unconsolidated basis, unless an exemption or safe harbor applies. We refer to this test as the “40% Test.” Securities issued by companies other than consolidated partner companies are generally considered “investment securities” for purposes of the Investment Company Act, unless other circumstances exist which actively involve the company holding such interests in the management of the underlying company. We are a company that partners with growth-stage companies to build value; we are not engaged primarily in the business of investing, reinvesting or trading in securities. We are in compliance with the 40% Test.

Consequently, we do not believe that we are an investment company under the Investment Company Act.

We monitor our compliance with the 40% Test and seek to conduct our business activities to comply with this test. It is not feasible for us to be regulated as an investment company because the Investment Company Act rules are inconsistent with our strategy of actively helping our partner companies in their efforts to build value. In order to continue to comply with the 40% Test, we may need to take various actions which we would otherwise not pursue.

For example, we may need to retain a controlling interest in a partner company that we no longer consider strategic, we may not be able to acquire an interest in a company unless we are able to obtain a controlling ownership interest in the company, or we may be limited in the manner or timing in which we sell our interests in a partner company. Our ownership levels also may be affected if our partner companies are acquired by third parties or if our partner companies issue stock which dilutes our controlling ownership interest. The actions we may need to take to address these issues while maintaining compliance with the 40% Test could adversely affect our ability to create and realize value at our partner companies.

Economic disruptions and downturns may have negative repercussions for us.

Events in the United States and international capital markets, debt markets and economies may negatively impact our ability to pursue certain tactical and strategic initiatives, such as accessing additional public or private equity or debt financing for us or for our partner companies and selling our interests in partner companies on terms acceptable to us and in time frames consistent with our expectations.

We cannot provide assurance that material weaknesses in our internal control over financial reporting will not be identified in the future.

We cannot assure you that material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in a material weakness, or could result in material misstatements in our Consolidated Financial Statements. These misstatements could result in a restatement of our Consolidated Financial Statements, cause us to fail to meet our reporting obligations and/or cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

#### Risks Related to Our Partner Companies

Most of our partner companies have a history of operating losses and/or limited operating history and may never be profitable.

Most of our partner companies have a history of operating losses and/or limited operating history, have significant historical losses and may never be profitable. Many have incurred substantial costs to develop and market their products, have incurred net losses and cannot fund their cash needs from operations. We expect that the operating expenses of certain of our

34

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partner companies will increase substantially in the foreseeable future as they continue to develop products and services, increase sales and marketing efforts, and expand operations.

Our partner companies face intense competition, which could adversely affect their business, financial condition, results of operations and prospects for growth.

There is intense competition in the technology and healthcare marketplaces, and we expect competition to intensify in the future. Our business, financial condition, results of operations and prospects for growth will be materially adversely affected if our partner companies are not able to compete successfully. Many of the present and potential competitors may have greater financial, technical, marketing and other resources than those of our partner companies. This may place our partner companies at a disadvantage in responding to the offerings of their competitors, technological changes or changes in client requirements. Also, our partner companies may be at a competitive disadvantage because many of their competitors have greater name recognition, more extensive client bases and a broader range of product offerings. In addition, our partner companies may compete against one another.

The success or failure of many of our partner companies is dependent upon the ultimate effectiveness of newly-created information technologies, medical devices, healthcare diagnostics, etc.

Our partner companies' business strategies are often highly dependent upon the successful launch and commercialization of an innovative information technology, medical device, healthcare diagnostic, or similar device or technology. Despite all of our efforts to understand the research and development underlying the innovation or creation of such technologies before we deploy capital into a partner company, sometimes the performance of the technology or device does not match our expectations or those of our partner company. In those situations, it is likely that we will incur a partial or total loss of the capital which we deployed in such partner company.

Our partner companies may fail if they do not adapt to changing marketplaces.

If our partner companies fail to adapt to changes in technology and customer and supplier demands, they may not become or remain profitable. There is no assurance that the products and services of our partner companies will achieve or maintain market penetration or commercial success, or that the businesses of our partner companies will be successful.

The healthcare and technology marketplaces are characterized by:

- rapidly changing technology;
- evolving industry standards;
- frequently introducing new products and services;
- shifting distribution channels;
- evolving government regulation;
- frequently changing intellectual property landscapes; and
- changing customer demands.

Our future success will depend on our partner companies' ability to adapt to these evolving marketplaces. They may not be able to adequately or economically adapt their products and services, develop new products and services or establish and maintain effective distribution channels for their products and services. If our partner companies are unable to offer competitive products and services or maintain effective distribution channels, they will sell fewer products and services and forego potential revenue, possibly causing them to lose money. In addition, we and our partner companies may not be able to respond to the marketplace changes in an economically efficient manner, and our partner companies may become or remain unprofitable.

Our partner companies may grow rapidly and may be unable to manage their growth.

We expect some of our partner companies to grow rapidly. Rapid growth often places considerable operational, managerial and financial strain on a business. To successfully manage rapid growth, our partner companies must, among other things:

- improve, upgrade and expand their business infrastructures;
- scale up production operations;
- develop appropriate financial reporting controls;
- attract and maintain qualified personnel; and
- maintain appropriate levels of liquidity.



If our partner companies are unable to manage their growth successfully, their ability to respond effectively to competition and to achieve or maintain profitability will be adversely affected.

Based on our business model, some or all of our partner companies will need to raise additional capital to fund their operations at any given time. We may not be able to fund some or all of such amounts and such amounts may not be available from third parties on acceptable terms, if at all.

We cannot be certain that our partner companies will be able to obtain additional financing on favorable terms when needed, if at all. Because our resources and our ability to raise capital are not unlimited, we may not be able to provide partner companies with sufficient capital resources to enable them to reach a cash-flow positive position, even if we wish to do so. General economic disruptions and downturns may also negatively affect the ability of some of our partner companies to fund their operations from other stockholders and capital sources. We also may fail to accurately project the capital needs of partner companies. If partner companies need capital but are not able to raise capital from us or other outside sources, then they may need to cease or scale back operations. In such event, our interest in any such partner company will become less valuable.

Economic disruptions and downturns may negatively affect our partner companies' plans and their results of operations.

Many of our partner companies are largely dependent upon outside sources of capital to fund their operations. Disruptions in the availability of capital from such sources will negatively affect the ability of such partner companies to pursue their business models and will force such companies to revise their growth and development plans accordingly. Any such changes will, in turn, negatively affect our ability to realize the value of our capital deployments in such partner companies.

In addition, downturns in the economy as well as possible governmental responses to such downturns and/or to specific situations in the economy could affect the business prospects of certain of our partner companies, including, but not limited to, in the following ways: weaknesses in the financial services industries; reduced business and/or consumer spending; and/or systemic changes in the ways the healthcare system operates in the United States.

Some of our partner companies may be unable to protect their proprietary rights and may infringe on the proprietary rights of others.

Our partner companies assert various forms of intellectual property protection. Intellectual property may constitute an important part of partner company assets and competitive strengths. Federal law, most typically copyright, patent, trademark and trade secret laws, generally protects intellectual property rights. Although we expect that our partner companies will take reasonable efforts to protect the rights to their intellectual property, third parties may develop similar intellectual property independently. Moreover, the complexity of international trade secret, copyright, trademark and patent law, coupled with the limited resources of our partner companies and the demands of quick delivery of products and services to market, create a risk that partner company efforts to prevent misappropriation of their technology will prove inadequate.

Some of our partner companies also license intellectual property from third parties and it is possible that they could become subject to infringement actions based upon their use of the intellectual property licensed from those third parties. Our partner companies generally obtain representations as to the origin and ownership of such licensed intellectual property. However, this may not adequately protect them. Any claims against our partner companies' proprietary rights, with or without merit, could subject the companies to costly litigation and divert their technical and management personnel from other business concerns. If our partner companies incur costly litigation and their personnel are not effectively deployed, the expenses and losses incurred by our partner companies will increase and their profits, if any, will decrease.

Third parties have and may assert infringement or other intellectual property claims against our partner companies based on their patents or other intellectual property claims. Even though we believe our partner companies' products do not infringe any third party's patents, they may have to pay substantial damages, possibly including treble damages, if it is ultimately determined that they do. They may have to obtain a license to sell their products if it is determined that their products infringe on another person's intellectual property. Our partner companies might be prohibited from selling their products before they obtain a license, which, if available at all, may require them to pay substantial royalties. Even if infringement claims against our partner companies are without merit, defending these types of lawsuits takes significant time, is expensive and may divert management attention from other business concerns.

Certain of our partner companies could face legal liabilities from claims made against their operations, products or work.

Because manufacture and sale of certain partner company products entail an inherent risk of product liability, certain partner companies maintain product liability insurance. Although none of our current partner companies have experienced any material losses in this regard, there can be no assurance that they will be able to maintain or acquire adequate product liability insurance in the future and any product liability claim could have a material adverse effect on a partner company's financial stability, revenues and results of operations. In addition, many of the engagements of our partner companies involve projects that are critical to the operation of their clients' businesses. If our partner companies fail to meet their contractual obligations, they could be subject to legal liability, which could adversely affect their business, operating results and financial condition.

Partner company contracts typically include provisions designed to limit their exposure to legal claims relating to their services and products. However, these provisions may not protect our partner companies or may not be enforceable. Also, some of our partner companies depend on their relationships with their clients and their reputation for high-quality services and integrity to retain and attract clients. As a result, claims made against our partner companies' work may damage their reputation, which in turn could impact their ability to compete for new work and negatively impact their revenue and profitability.

Our partner companies' success depends on their ability to attract and retain qualified personnel.

Our partner companies depend upon their ability to attract and retain senior management and key personnel, including trained technical and marketing personnel. Our partner companies also will need to continue to hire additional personnel as they expand. Although our partner companies have not been the subject of a work stoppage, any future work stoppage could have a material adverse effect on their respective operations. A shortage in the availability of the requisite qualified personnel or work stoppage would limit the ability of our partner companies to grow, to increase sales of their existing products and services, and to launch new products and services.

Government regulations and legal uncertainties may place financial burdens on the businesses of our partner companies.

Failure to comply with applicable requirements of the FDA or comparable regulation in foreign countries can result in fines, recall or seizure of products, total or partial suspension of production, withdrawal of existing product approvals or clearances, refusal to approve or clear new applications or notices and criminal prosecution. Manufacturers of pharmaceuticals and medical diagnostic devices and operators of laboratory facilities are subject to strict federal and state regulation regarding validation and the quality of manufacturing and laboratory facilities. Failure to comply with these quality regulation systems requirements could result in civil or criminal penalties or enforcement proceedings, including the recall of a product or a "cease distribution" order. The enactment of any additional laws or regulations that affect healthcare insurance policy and reimbursement (including Medicare reimbursement) could negatively affect some of our partner companies. If Medicare or private payors change the rates at which our partner companies or their customers are reimbursed by insurance providers for their products, such changes could adversely impact our partner companies.

Some of our partner companies may be subject to significant environmental, health and safety regulation.

Some of our partner companies may be subject to licensing and regulation under federal, state and local laws and regulations relating to the protection of the environment and human health and safety, including laws and regulations relating to the handling, transportation and disposal of medical specimens, infectious and hazardous waste and radioactive materials, as well as to the safety and health of manufacturing and laboratory employees. In addition, the federal Occupational Safety and Health Administration has established extensive requirements relating to workplace safety.

Catastrophic events may disrupt our partner companies' businesses.

Some of our partner companies are highly automated businesses and rely on their network infrastructure, various software applications and many internal technology systems and data networks for their customer support, development, sales and marketing and accounting and finance functions. Further, some of our partner companies provide services to their customers from data center facilities in multiple locations. Some of these data centers are operated by third parties, and the partner companies have limited control over those facilities. A disruption or failure of these systems or data centers in the event of a natural disaster, telecommunications failure, power outage, cyber-attack, war, terrorist attack or other catastrophic event could cause system interruptions, reputational harm, delays in product development, breaches of data security and loss of critical data. Such an event could also prevent the partner companies from fulfilling customer orders or maintaining certain service level requirements, particularly in respect of their SaaS offerings. While certain of our partner companies have developed certain disaster recovery plans and maintain backup systems to reduce the potentially adverse effect of such events, a catastrophic event that resulted in the destruction or disruption of any of their data centers or their critical business or information technology systems could severely affect their ability to conduct normal business operations and, as a result, their business, operating results and financial condition could be adversely affected.

We cannot provide assurance that our partner companies' disaster recovery plans will address all of the issues they may encounter in the event of a disaster or other unanticipated issue, and their business interruption insurance may not

adequately compensate them for losses that may occur from any of the foregoing. In the event that a natural disaster, terrorist attack or other catastrophic event were to destroy any part of their facilities or interrupt their operations for any extended period of time, or if harsh weather or health conditions prevent them from delivering products in a timely manner, their business, financial condition and operating results could be adversely affected.



### Risks Related to Our Initiatives to Expand Our Platform

Our involvement in the mezzanine lending industry through our relationship with Penn Mezzanine could expose us to risks that differ from, and may be in addition to, the risks that otherwise relate to our other business initiatives. Borrowers may default on their payments, which may have a negative effect on our financial performance.

Through our relationship with Penn Mezzanine, we participate in long-term loans and in equity securities primarily in private middle-market companies, which may involve a high degree of repayment risk. These borrowers may have limited financial resources, may be highly leveraged and may be unable to obtain financing from traditional sources. Numerous factors may affect a borrower's ability to repay its loan, including the failure to meet its business plan, a downturn in its industry or negative economic conditions. A borrower's failure to satisfy financial or operating covenants imposed by Penn Mezzanine or other lenders could lead to defaults and, potentially, termination of its loans or foreclosure on its secured assets, which could trigger cross defaults under other agreements and jeopardize such borrower's ability to meet its obligations under the participations in loans or debt interests that we hold. In addition, such borrowers may have, or may be permitted to incur, other debt that ranks senior to or equally with our interests. This means that payments on such senior-ranking securities may have to be made before we receive any payments on our interests in subordinated loans or other debt securities. Deterioration in a borrower's financial condition and prospects may be accompanied by deterioration in any related collateral and may have a negative effect on our financial results.

We may become subject to additional laws and regulations, including the laws and regulations of other countries, as we engage in platform expansion activities.

In connection with our platform expansion activities, we may manage the deployment of capital that originates other than on our balance sheet, which could include capital originating from international sources. If we were engaged in such activities, we could become subject to additional laws and regulations, including the laws and regulations of countries other than the United States, which could increase our expenses and the costs associated with legal and regulatory compliance as well as the risk of noncompliance.

### Subordination

The loans and other vehicles we participate in will typically be subordinated to the senior obligations of our borrowers (all or a significant portion of which may be secured), either contractually or structurally, in the case of debt securities, or because of the nature of the security, in the case of preferred stock, common stock, warrants or other equity securities. Such subordinated instruments may be characterized by greater credit risk than those associated with senior obligations of the same borrower. Adverse changes in the financial condition of a borrower, general economic conditions, or both may impair the ability of such borrower to make payments on the subordinated instruments and result in defaults on such instruments more quickly than in the case of the senior obligations of such borrower.

### Debt securities

Our participation in debt instruments and obligations entails normal credit risks (i.e., the risk of non-payment of interest and principal), as well as other creditor risks, including (i) the possible invalidation of an investment transaction as a "fraudulent conveyance" under relevant creditors' rights laws, (ii) so-called "lender liability" claims by the borrower, and (iii) environmental liabilities that may arise with respect to collateral securing the obligations. A debt instrument or obligation may also be subject to prepayment or redemption at the option of the borrower. Pursuant to rights granted to Penn Mezzanine by borrowers, Penn Mezzanine will often oversee or play a role in the management of its borrowers. If a court were to find that Penn Mezzanine's influence on the management of a borrower caused the borrower to take actions that were in Penn Mezzanine's interests and not in the best interests of the creditors and stockholders of the borrower as a whole, the court could cause Penn Mezzanine's claims, which normally would be subordinated only to any senior debt of the borrower, to be subordinated to the claims of all creditors of the borrower and, in certain circumstances, the claims of the stockholders. Since we participate in the loans and other transactions entered into by Penn Mezzanine, we would be adversely affected by any such circumstance.

### Leverage

Our Penn Mezzanine participations are expected to include borrowers with significant levels of debt. Such situations are inherently more sensitive than others to declines in revenues and to increases in expenses and interest rates. The leveraged capital structure of such borrowers will increase the exposure of those borrowers to bad business planning, adverse economic factors (or other factors) such as downturns in the economy or deterioration in the condition of the

borrower or its industry. Because these participations involve subordinated obligations, among the most junior in a borrower's capital structure, the inability of a borrower to service its debt obligations could result in a loss of our principal.

### Minority positions

The loans in which we participate will generally represent minority interests in borrowers. Penn Mezzanine will not likely be able to control or exercise substantial influence over such borrowers.

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

We are exposed to equity price risks on the marketable portion of our ownership interests in our partner companies and other assets. At September 30, 2013, these interests include our equity positions in NuPathe and Tengion, both publicly-traded entities, which have experienced significant volatility in their stock prices. Historically, we have not attempted to reduce or eliminate our market exposure related to these types of interests. Based on closing market prices at September 30, 2013, the aggregate fair market value of our holdings in NuPathe and Tengion was \$14.6 million. A 20% decrease in NuPathe and Tengion's stock price would result in an approximate \$3.3 million decrease in the aggregate fair value of our holdings in these companies.

We have \$55.5 million outstanding in convertible senior debentures with stated maturities through March 15, 2024. The 2024 Debentures holders have the right to require the Company to repurchase the 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount, plus accrued and unpaid interest. In November 2012, we issued \$55.0 million in face amount of our 2018 Debentures and repurchased substantially all of our 2014 Debentures outstanding.

Liabilities	Remainder of 2013	2014	2015	After 2015	Fair Value at September 30, 2013
2024 Debentures due by year (in millions)	\$ —	\$0.4	\$—	\$—	\$ 0.4
Fixed interest rate	2.625	% 2.625	% 2.625	% 2.625	% N/A
Interest expense (in millions)	\$ —	\$—	\$—	\$—	N/A
2014 Debentures due by year (in millions)	\$ —	\$—	\$—	\$—	\$ —
Fixed interest rate	10.125	% 10.125	% N/A	N/A	N/A
Interest expense (in millions)	\$ —	\$—	\$—	\$—	N/A
2018 Debentures due by year (in millions)	\$ —	\$—	\$—	\$55.0	\$ 59.4
Fixed interest rate	5.25	% 5.25	% 5.25	% 5.25	% N/A
Interest expense (in millions)	\$ 0.7	\$2.9	\$2.9	\$6.8	N/A

### Item 4. Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of September 30, 2013 are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

#### (b) Change in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



PART II

OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

There have been no material changes in our risk factors from the information set forth above under the heading “Factors That May Affect Future Results” and in our Annual Report on Form 10-K for the year ended December 31, 2012.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

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## Item 6. Exhibits

## (a) Exhibits.

The following is a list of exhibits required by Item 601 of Regulation S-K to be filed as part of this Report. For exhibits that previously have been filed, the Registrant incorporates those exhibits herein by reference. The exhibit table below includes the Form Type and Filing Date of the previous filing and the location of the exhibit in the previous filing which is being incorporated by reference herein. Documents which are incorporated by reference to filings by parties other than the Registrant are identified in a footnote to this table.

Exhibit Number	Description
10.1 *	Key Employee Compensation Recoupment Policy (filed on July 26, 2013 as Exhibit 10.2 to the Quarterly Report on Form 10-Q).
31.1 †	Certification of Stephen T. Zarrilli pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934.
31.2 †	Certification of Jeffrey B. McGroarty pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934.
32.1 ‡	Certification of Stephen T. Zarrilli pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 ‡	Certification of Jeffrey B. McGroarty pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from Safeguard Scientifics, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets (unaudited) – September 30, 2013 and December 31, 2012; (ii) Consolidated Statements of Operations (unaudited) – Three and nine months ended September 30, 2013 and 2012; (iii) Consolidated Statements of Comprehensive Loss (unaudited) – Three and nine months ended September 30, 2013 and 2012; (iv) Condensed Consolidated Statements of Cash Flows (unaudited) – Nine months ended September 30, 2013 and 2012; (v) Consolidated Statement of Changes in Equity (unaudited) – Nine months ended September 30, 2013; and (vi) Notes to Consolidated Financial Statements (unaudited).

† Filed herewith

‡ Furnished herewith

\* These exhibits relate to management contracts or compensatory plans, contracts or arrangements in which directors and/or executive officers of the Registrant may participate.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: October 25, 2013

SAFEGUARD SCIENTIFICS, INC.

/s/ Stephen T. Zarrilli

Stephen T. Zarrilli

President and Chief Executive Officer

Date: October 25, 2013

/s/ Jeffrey B. McGroarty

Jeffrey B. McGroarty

Senior Vice President and Chief Financial Officer