

SAFEGUARD SCIENTIFICS INC

Form 10-Q

October 26, 2017

UNITED STATES  
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, 2017

or

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.)

170 North Radnor-Chester Road

Suite 200

Radnor, PA

19087

(Address of principal executive offices) (Zip Code)

(610) 293-0600

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 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, a smaller reporting company or an emerging growth 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  Smaller reporting company

Non-accelerated filer  (Do not check if a smaller reporting  
emerging growth company)

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company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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, 2017

Common Stock 20,412,398

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SAFEGUARD SCIENTIFICS, INC.  
QUARTERLY REPORT ON FORM 10-Q  
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SAFEGUARD SCIENTIFICS, INC.  
CONSOLIDATED BALANCE SHEETS  
(Unaudited - In thousands, except per share data)

	September 30, 2017	December 31, 2016
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 34,317	\$ 22,058
Marketable securities	5,171	8,384
Trading securities	3,881	—
Prepaid expenses and other current assets	3,691	2,109
Total current assets	47,060	32,551
Property and equipment, net	1,626	1,873
Ownership interests in and advances to partner companies	138,698	183,470
Long-term marketable securities	249	7,302
Long-term restricted cash equivalents	6,336	6,336
Other assets	316	296
Total Assets	\$ 194,285	\$ 231,828
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 171	\$ 140
Accrued compensation and benefits	2,844	3,498
Accrued expenses and other current liabilities	2,495	2,223
Convertible senior debentures - current	40,148	—
Total current liabilities	45,658	5,861
Other long-term liabilities	3,504	3,630
Credit facility	44,911	—
Convertible senior debentures	—	52,560
Total Liabilities	94,073	62,051
Commitments and contingencies		
Equity:		
Preferred stock, \$0.10 par value; 1,000 shares authorized	—	—
Common stock, \$0.10 par value; 83,333 shares authorized; 21,573 shares issued at September 30, 2017 and December 31, 2016	2,157	2,157
Additional paid-in capital	815,031	816,016
Treasury stock, at cost; 1,161 and 1,209 shares at September 30, 2017 and December 31, 2016, respectively	(20,124 )	(21,061 )
Accumulated deficit	(696,748 )	(626,904 )
Accumulated other comprehensive loss	(104 )	(431 )
Total Equity	100,212	169,777
Total Liabilities and Equity	\$ 194,285	\$ 231,828

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,	
	2017	2016	2017	2016
General and administrative expense	\$3,758	\$4,687	\$13,191	\$14,764
Operating loss	(3,758 )	(4,687 )	(13,191 )	(14,764 )
Other loss	(379 )	(2,405 )	(219 )	(1,746 )
Interest income	1,004	513	2,892	1,460
Interest expense	(2,643 )	(1,161 )	(5,953 )	(3,465 )
Equity income (loss)	(12,874 )	(16,345 )	(53,373 )	17,954
Net loss before income taxes	(18,650 )	(24,085 )	(69,844 )	(561 )
Income tax benefit (expense)	—	—	—	—
Net loss	\$(18,650)	\$(24,085)	\$(69,844)	\$(561 )
Net loss per share:				
Basic	\$(0.91 )	\$(1.18 )	\$(3.42 )	\$(0.03 )
Diluted	\$(0.91 )	\$(1.18 )	\$(3.42 )	\$(0.03 )
Weighted average shares used in computing loss per share:				
Basic	20,455	20,387	20,416	20,390
Diluted	20,455	20,387	20,416	20,390

See Notes to Consolidated Financial Statements.

## SAFEGUARD SCIENTIFICS, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited - In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net loss	\$(18,650)	\$(24,085)	\$(69,844)	\$(561)
Other comprehensive loss:				
Share of other comprehensive income of equity method investments	274	3	277	13
Reclassification adjustment for sale of equity method investments	—	—	50	—
Total comprehensive loss	\$(18,376)	\$(24,082)	\$(69,517)	\$(548)

See Notes to Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2017	2016
Cash Flows from Operating Activities:		
Net cash used in operating activities	\$(15,515)	\$(14,114)
Cash Flows from Investing Activities:		
Proceeds from sales of and distributions from companies	16,604	73,854
Acquisitions of ownership interests in companies	(11,851 )	(34,841 )
Advances and loans to companies	(16,933 )	(17,741 )
Repayment of advances and loans to companies	—	1,741
Increase in marketable securities	—	(18,733 )
Decrease in marketable securities	10,268	35,386
Capital expenditures	—	(73 )
Net cash provided by (used in) investing activities	(1,912 )	39,593
Cash Flows from Financing Activities:		
Proceeds from credit facility	50,000	—
Issuance costs of credit facility	(5,696 )	—
Repurchase of convertible senior debentures	(14,455 )	—
Issuance of Company common stock, net	12	5
Tax withholdings related to equity-based awards	(175 )	(437 )
Repurchase of Company common stock	—	(5,389 )
Net cash provided by (used in) financing activities	29,686	(5,821 )
Net change in cash, cash equivalents and restricted cash equivalents	12,259	19,658
Cash, cash equivalents and restricted cash equivalents at beginning of period	28,394	32,838
Cash, cash equivalents and restricted cash equivalents at end of period	\$40,653	\$52,496
See Notes to Consolidated Financial Statements.		



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

	Total	Accumulated Deficit	Accumulated Other Comprehensive Loss	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Treasury Stock Shares	Treasury Stock Amount
Balance - December 31, 2016	\$ 169,777	\$ (626,904 )	\$ (431 )	21,573	\$ 2,157	\$ 816,016	1,209	\$ (21,061)
Net loss	(69,844 )	(69,844 )	—	—	—	—	—	—
Stock options exercised, net of tax withholdings	12	—	—	—	—	(48 )	(4 )	60
Issuance of restricted stock, net of tax withholdings	(40 )	—	—	—	—	(917 )	(44 )	877
Stock-based compensation expense	806	—	—	—	—	806	—	—
Repurchase of convertible senior debentures	(826 )	—	—	—	—	(826 )	—	—
Other comprehensive income	327	—	327	—	—	—	—	—
Balance - September 30, 2017	\$ 100,212	\$ (696,748 )	\$ (104 )	21,573	\$ 2,157	\$ 815,031	1,161	\$ (20,124)

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 2016 Annual Report on Form 10-K.

Liquidity

As of September 30, 2017, the Company had \$34.3 million of cash and cash equivalents and \$5.4 million of marketable securities for a total of \$39.7 million. As of September 30, 2017, the Company had \$41.0 million of principal outstanding on its convertible senior notes, which the Company anticipates repaying or refinancing by the maturity date of May 15, 2018.

In May 2017, the Company entered into a \$75.0 million secured, revolving credit facility (“Credit Facility”) with HPS Investment Partners, LLC (“Lender”). As of September 30, 2017, the Company had \$50.0 million of principal outstanding on the Credit Facility due in May 2020. The Credit Facility requires the Company to maintain (i) a liquidity threshold of at least \$20 million of unrestricted cash; (ii) a tangible net worth, plus unrestricted cash, of at least 1.75x the amount then outstanding under the Credit Facility; (iii) a minimum aggregate appraised value of the Company’s ownership interests in its partner companies, plus unrestricted cash in excess of the liquidity threshold, of at least \$350 million; and (iv) certain diversification requirements and concentration limits with respect to the Company’s capital deployments to its partner companies. As of the date these consolidated financial statements were issued, the Company was in compliance with all of these covenants.

The Company funds its operations with cash and marketable securities on hand as well as proceeds from the sales of its interest in its partner companies. Due to the nature of the mergers and acquisitions market, and the developmental cycle of companies like the Company’s partner companies, the Company’s ability to generate specific amounts of liquidity from sales of its partner company interests in any given period of time cannot be assured. Accordingly, the forecasts which the Company utilizes for projecting future compliance with covenants related to its Credit Facility include significantly discounted probability-weighted proceeds from the sales of its interests in its partner companies. Based on these forecasts, management believes the Company will continue to remain in compliance with all of its debt covenants. Management’s plans to remain in compliance with these covenants include selling certain of its partner company interests in the ordinary course of its business and limiting capital deployments to new and existing partner companies.

Non-compliance with any of the covenants would constitute an event of default under the Credit Facility, and the Lender could choose to accelerate the maturity of the indebtedness. If the Lender were to accelerate the maturity of the indebtedness, the Company may not have sufficient immediate liquidity to repay the entire balance of its outstanding borrowings and other obligations under the Credit Facility. Should the Company not be in compliance with any of its debt covenants and be unable to obtain waivers for such events of default, management would pursue one of a number of potential alternatives to satisfy the obligations, including completing an equity offering or obtaining a new debt facility to refinance its existing debt.

Significant Accounting Policies

Restricted Cash Equivalents

Restricted cash equivalents consist of certificates of deposit with various maturity dates. Amounts included in restricted cash equivalents represent those required to be set aside by a contractual agreement with a bank as collateral for a letter of credit. The restriction on the cash will lapse when the related letter of credit is terminated or expires. The letter of credit is scheduled to expire on March 31, 2019. The following table provides a reconciliation of cash, cash equivalents and restricted cash equivalents reported within the Consolidated Balance Sheets that sum to the total of the same such amounts shown in the Consolidated Statements of Cash Flows:

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	September 30, 2017	December 31, 2016
	(Unaudited - In thousands)	
Cash and cash equivalents	\$34,317	\$ 22,058
Long-term restricted cash equivalents	6,336	6,336
Total cash, cash equivalents and restricted cash equivalents	\$40,653	\$ 28,394

### Recent Accounting Pronouncements

#### Evaluation of Accounting Standards Update No. 2014-09

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). ASU 2014-09 and related subsequent amendments outline a single comprehensive model to use to account for revenue arising from contracts with customers and supersede most current revenue recognition guidance. For public companies, the guidance is effective for annual periods beginning after December 15, 2017 and any interim periods that fall within that reporting period. For nonpublic companies, the guidance is effective for annual periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019 with early adoption permitted. As the new standard will supersede most existing revenue guidance, it could impact revenue and cost recognition for partner companies. Any change in revenue or cost recognition for partner companies could affect the Company's recognition of its share of the results of its equity method partner companies. The Company has been closely monitoring the FASB and SEC activity related to the new standard. On July 20, 2017, the SEC staff observer at the FASB's Emerging Issues Task Force ("EITF") meeting announced that the SEC staff will not object if a private company equity method investee meeting the definition of a public business entity that otherwise would not meet the definition of a public business entity except for the inclusion of its financial statements or financial information in another entity's filings with the SEC, uses private company adoption dates for the new revenue standard. As a result, the Company anticipates that its private, calendar year partner companies will adopt the new revenue standard for the year ending December 31, 2019. The impact of adoption of the new revenue standard will be reflected in the Company's financial results for the interim and annual reporting periods beginning in 2020 on a one quarter-lag basis.

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

The following summarizes the carrying value of the Company's ownership interests in and advances to partner companies.

	September 30, 2017	December 31, 2016
	(Unaudited - In thousands)	
Equity Method:		
Partner companies	\$ 113,869	\$ 154,219
Private equity funds	444	447
	114,313	154,666
Cost Method:		
Other holdings	2,762	2,112
Private equity funds	1,334	1,550
	4,096	3,662
Advances to partner companies	20,289	25,142
	\$ 138,698	\$ 183,470

In August 2017, Good Start Genetics, Inc. was acquired by Invitae Corporation ("Invitae"). The Company received 414,237 shares of Invitae common stock worth \$4.3 million on the closing date in connection with the transaction,

excluding 137,125 shares of Invitae common stock worth \$1.4 million on the closing date which will be held in escrow until August 2018. The Company recognized a gain of \$4.3 million on the transaction, which is included in Equity income (loss) in the Consolidated Statements of Operations for the three and nine months ended September 30, 2017. The Invitae shares are classified as Trading securities and recorded at fair value on the Consolidated Balance Sheet at September 30, 2017.

In March 2017, the Company sold its interest in partner company Nexxt, Inc., formerly Beyond.com, back to Nexxt, Inc. for \$26.0 million. The Company received \$15.5 million in cash and a three-year, \$10.5 million note for the balance due, which accrues interest at a rate of 9.5% per annum. The receipt of the \$15.5 million in cash resulted in a gain of \$0.1 million which is included in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2017.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The \$10.5 million note is fully reserved and has a carrying value of zero as of September 30, 2017. A gain will be recorded when the note is repaid. Interest is payable annually and interest income is recorded as earned throughout the year.

In the second quarter of 2017, the Company recognized an impairment charge of \$3.6 million related to Spongecell, Inc. which is reflected in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2017. The impairment was based on the value at which the Company expects Spongecell to raise its next financing round.

In the first and second quarters of 2017, the Company recognized impairment charges of \$2.7 million and \$2.2 million, respectively, related to Pneuron, Inc. which is reflected in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2017. The impairments were due to a decline in revenue and an inability to attract third party investors or acquirers. Pneuron has ceased business operations and the adjusted carrying value of the Company's interest in Pneuron is \$0.0 million at September 30, 2017.

In April 2016, Putney, Inc. was acquired by Dechra Pharmaceuticals Plc. The Company received \$58.6 million in cash proceeds in connection with the transaction. In April 2017, the Company received an additional \$0.7 million in connection with the expiration of the final escrow period resulting in a gain of \$0.7 million which is included in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2017.

In July 2015, Quantia, Inc. was acquired by Physicians Interactive. The Company received \$7.8 million in initial cash proceeds in connection with the transaction in July 2015 and \$0.6 million in connection with the expiration of the initial escrow period in July 2016. In January 2017, the Company received an additional \$0.6 million in connection with the expiration of the final escrow period resulting in a gain of \$0.6 million which is included in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2017.

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

In September, August, March and February 2017, the Company funded an aggregate of \$4.9 million of convertible bridge loans to InfoBionic, Inc. The Company had previously deployed an aggregate of \$14.5 million in InfoBionic. InfoBionic is an emerging digital health company focused on creating patient monitoring solutions for chronic disease management with an initial market focus on cardiac arrhythmias. The Company accounts for its interest in InfoBionic under the equity method.

In September, July and June 2017, the Company funded an aggregate of \$1.6 million of convertible bridge loans to Cask Data, Inc. The Company had previously deployed an aggregate of \$11.0 million in Cask Data. Cask Data makes building and running big data solutions on-premises or in the cloud easy with Cask Data Application Platform. The Company accounts for its interest in Cask Data under the equity method.

In September 2017, the Company deployed \$2.5 million into meQuilibrium. The Company had previously deployed an aggregate of \$8.0 million in meQuilibrium. meQuilibrium is a digital coaching platform that delivers clinically validated and highly personalized resilience solutions to employers, health plans, wellness providers and consumers increasing engagement, productivity and performance, as well as improving outcomes in managing stress, health and well-being. The Company accounts for its interest in meQuilibrium under the equity method.

In August 2017, the Company funded \$0.3 million of convertible bridge loans to Hoopla Software, Inc. The Company had previously deployed an aggregate of \$4.8 million in Hoopla Software. Hoopla Software provides cloud-based software that helps sales organizations inspire and motivate sales team performance. The Company accounts for its interest in Hoopla Software under the equity method.

In August, June and February 2017, the Company funded an aggregate of \$1.5 million of convertible loans to NovaSom, Inc. The Company had previously deployed an aggregate of \$22.1 million in NovaSom. NovaSom is a medical device company focused on obstructive sleep apnea, specifically home testing with its FDA-cleared wireless device called AccuSom<sup>®</sup> home sleep test. The Company accounts for its interest in NovaSom under the equity method.

In July 2017, the Company deployed \$1.8 million into QuanticMind, Inc. The Company had previously deployed an aggregate of \$9.7 million in QuanticMind. QuanticMind delivers the most intelligent, scalable and fastest platform for maximizing digital marketing performance, including paid search and social, for enterprises. The Company accounts for its interest in QuanticMind under the equity method.

In June and April 2017, the Company funded an aggregate of \$3.0 million of a convertible bridge loan to Sonobi, Inc. The Company had previously deployed \$5.4 million in Sonobi. Sonobi is an advertising technology developer that designs advertising tools and solutions for the industry's leading media, publishers, brand advertisers, media agencies, DSPs, and media technology providers. The Company accounts for its interest in Sonobi under the equity method.

In June and January 2017, the Company funded an aggregate of \$2.0 million of convertible bridge loans to WebLinc, Inc. The Company had previously deployed an aggregate of \$12.0 million in WebLinc. WebLinc is a commerce platform and services provider for fast growing online retailers. The Company accounts for its interest in WebLinc under the equity method.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In June 2017, the Company funded \$1.8 million of a convertible bridge loan to Good Start Genetics, Inc. The Company had previously deployed an aggregate of \$17.2 million in Good Start Genetics. Good Start Genetics was acquired by Invitae Corporation in August 2017.

In May 2017, the Company deployed \$2.1 million into Trice Medical, Inc. The Company had previously deployed an aggregate of \$8.0 million in Trice Medical. Trice Medical is a diagnostics company focused on micro invasive technologies. The Company accounts for its interest in Trice Medical under the equity method.

In April 2017, the Company deployed \$1.5 million into Aktana, Inc. The Company had previously deployed an aggregate of \$8.2 million in Aktana. Aktana leverages big data and machine learning to enable pharmaceutical brands to dynamically optimize their strategy and enhance sales execution. The Company accounts for its interest in Aktana under the equity method.

In March and January 2017, the Company deployed an aggregate of \$2.0 million into CloudMine, Inc. The Company had previously deployed an aggregate of \$5.5 million in CloudMine. CloudMine empowers payers, providers, and pharmaceutical organizations to mobilize patient information by building robust applications and driving actionable insights. The Company accounts for its interest in CloudMine under the equity method.

In March 2017, the Company funded \$0.2 million of a bridge loan to Lumesis, Inc. The Company had previously deployed an aggregate of \$6.2 million in Lumesis. Lumesis is a financial technology company focused on providing business efficiency, regulatory and data solutions to the municipal bond marketplace. The Company accounts for its interest in Lumesis under the equity method.

In January 2017, the Company deployed \$2.4 million into Full Measure Education, Inc. The Company had previously deployed an aggregate of \$8.6 million in Full Measure. Full Measure designs next-generation, mobile-first technologies for colleges throughout the United States. The Company accounts for its interest in Full Measure under the equity method.

In January 2017, the Company funded \$0.3 million of a convertible bridge loan to Aventura, Inc. to fund wind-down activities. The Company had previously deployed an aggregate of \$6.2 million in Aventura. The adjusted carrying value of the Company's interest in Aventura was \$0.0 million at September 30, 2017. The Company accounted for its interest in Aventura under the equity 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 instruments 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.

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, 2017 and December 31, 2016:

	Carrying Value	Fair Value Measurement at September 30, 2017		
		Level 1	Level 2	Level 3
(Unaudited - In thousands)				
Cash and cash equivalents	\$34,317	\$34,317	\$ —	—
Long-term restricted cash equivalents	6,336	6,336	—	—



Trading securities	3,881	3,881	—	—	
Marketable securities—held-to-maturity:					
Certificates of deposit	\$5,420	\$5,420	\$	—\$	—
Total marketable securities	\$5,420	\$5,420	\$	—\$	—

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## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Carrying Value	Fair Value Measurement at December 31, 2016		
		Level 1	Level 2	Level 3
(Unaudited - In thousands)				
Cash and cash equivalents	\$22,058	\$22,058	\$ —	\$ —
Long-term restricted cash equivalents	6,336	6,336	—	—
Marketable securities—held-to-maturity:				
Certificates of deposit	\$15,686	\$15,686	\$ —	\$ —
Total marketable securities	\$15,686	\$15,686	\$ —	\$ —

As of September 30, 2017, \$5.2 million of marketable securities had contractual maturities which were less than one year and \$0.2 million of marketable securities had contractual maturities greater than one year. Certificates of deposit are classified as held-to-maturity securities 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. Trading securities consist of 414,237 shares of Invitae Corporation common shares obtained in connection with the sale of Good Start Genetics. The trading securities are carried at fair value based on the closing stock price on the last trading day of the reporting period.

## 5. Credit Facility and Convertible Debentures

### Credit Facility

In May 2017, the Company entered into a \$75.0 million secured, revolving credit facility (“Credit Facility”) with HPS Investment Partners, LLC (“Lender”). At closing, the Company borrowed \$50.0 million, which resulted in net proceeds of \$44.3 million after closing fees to the Lender and other third parties. The Credit Facility has a three-year term with a scheduled maturity of May 11, 2020 and bears interest at a rate of either: (A) LIBOR plus 8.5% (subject to a LIBOR floor of 1%), payable on the last day of the one, two or three month interest period applicable to the LIBOR rate advance, or (B) 7.5% plus the greater of: 2%; the Federal Funds Rate plus 0.5%; LIBOR plus 1%; or the U.S. Prime Rate, payable monthly in arrears. The Credit Facility is not amortized and interest payable under the Credit Facility will reflect at least \$50 million as being drawn and outstanding at all times during the term. The Credit Facility also includes an unused line fee equal to 0.75% per annum of the average unused portion of the Credit Facility and a loan service fee, both paid quarterly. The Credit Facility is secured by all of the Company’s assets in accordance with the terms of the Credit Facility.

The Credit Facility requires the Company to maintain (i) a liquidity threshold of at least \$20 million of unrestricted cash; (ii) a tangible net worth, plus unrestricted cash of at least 1.75x the amount then outstanding under the Credit Facility; (iii) a minimum aggregate appraised value of the Company’s ownership interests in its partner companies, plus unrestricted cash in excess of the liquidity threshold of at least \$350 million; and (iv) certain diversification requirements and concentration limits with respect to the Company’s capital deployments to its partner companies. Subject to customary exclusions, the Lender has the right to have one observer representative attend meetings of the Company’s Board of Directors.

The Credit Facility provides for customary events of default which include (subject in certain cases to customary grace and cure periods), among others, nonpayment of principal or interest; non-compliance with debt covenants; defaults in, or failure to pay, certain other indebtedness; the rendering of judgments to pay certain amounts of money; and certain events of bankruptcy or insolvency. Generally, if an event of default occurs and is not cured within the time periods specified (if any), the Lender may declare the outstanding amount under the Credit Facility to be immediately due and payable.

At September 30, 2017, the principal amount outstanding under the Credit Facility was \$50.0 million, the unamortized discount and debt issuance costs were \$5.1 million and the net carrying value of the credit facility was \$44.9 million.

The Company is amortizing the excess of the principal amount of the Credit Facility over its carrying value over the three-year term as additional interest expense using the effective interest method and recorded \$0.4 million and \$0.6 million of such expense for the three and nine months ended September 30, 2017. The effective interest rate on the Credit Facility is 14.5%.

#### Convertible Debentures

In November 2012, the Company issued \$55.0 million principal amount of its 5.25% convertible senior debentures due on May 15, 2018 (the "2018 Debentures"). The 2018 Debentures may be settled in cash or partially in cash upon conversion. Accordingly, 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.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In July and June 2017, the Company repurchased on the open market, and retired, an aggregate of \$14.0 million face value of the 2018 Debentures at a cost of \$14.5 million, including transaction fees. In connection with the repurchase of these 2018 Debentures, the Company recognized a \$0.8 million reduction in equity which is included in Accumulated Paid-In Capital in the Consolidated Balance Sheet as of September 30, 2017 and a \$29 thousand loss on extinguishment of the liability which is included in Other loss in the Consolidated Statements of Operations for the nine months ended September 30, 2017.

At September 30, 2017, the carrying amount of the equity component was \$5.7 million, the principal amount of the liability component was \$41.0 million, the unamortized discount and debt issuance costs were \$0.9 million and the net carrying value of the liability component was \$40.1 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 \$0.4 million of such expense for the three months ended September 30, 2017 and 2016, and \$1.6 million and \$1.2 million for the nine months ended September 30, 2017 and 2016, respectively. The effective interest rate on the 2018 Debentures is 8.7%. At September 30, 2017, the fair value of the \$41.0 million outstanding 2018 Debentures was approximately \$42.2 million, based on the midpoint of the bid and ask prices as of such date. The Company anticipates repaying or refinancing the outstanding 2018 Debentures by the maturity date of May 15, 2018.

## 6. Stock-Based Compensation

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

	Three months ended September 30, 2017	Three months ended September 30, 2016	Nine months ended September 30, 2017	Nine months ended September 30, 2016
General and administrative expense	\$560	\$604	\$806	\$1,879
	\$560	\$604	\$806	\$1,879

The fair value of the Company's option 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, 2017, the Company had outstanding options that vest based on two different types of vesting schedules:

- 1) performance-based;
- 2) service-based.

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, 2017 and 2016, the Company did not issue any performance-based options to employees. During the nine months ended September 30, 2017 and 2016, 0 thousand and 4 thousand

performance-based options vested, respectively. During the nine months ended September 30, 2017 and 2016, 8 thousand and 35 thousand performance-based options were canceled or forfeited. The Company recorded compensation expense related to performance-based options of \$0.0 million for the three months ended September 30, 2017 and a reduction in compensation expense of \$0.2 million for the nine months ended September 30, 2017. The Company recorded compensation expense related to performance-based options of \$0.0 million and \$0.2 million for the three and nine months ended September 30, 2016, respectively. The maximum number of unvested options at September 30, 2017 attainable under these grants was 284 thousand shares.

Service-based options 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 options is the period over which the award vests. During the nine months ended September 30, 2017 and 2016, the Company issued 0 thousand and 12 thousand service-based options, respectively, to employees. During the nine months ended September 30, 2017 and 2016, 78 thousand and 12 thousand service-based options, respectively, were canceled or forfeited. The Company recorded compensation expense related to service-based options of \$0.0 million and \$0.1 million

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

for the three and nine months ended September 30, 2017, respectively. The Company recorded compensation expense related to service-based options of \$0.1 million and \$0.1 million for the three and nine months ended September 30, 2016, respectively.

Performance-based stock units vest based on 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, as described above related to performance-based awards. Performance-based stock units represent the right to receive shares of the Company's common stock, on a one-for-one basis. During the nine months ended September 30, 2017 and 2016, the Company did not issue any performance-based stock units to employees and no performance-based stock units vested. During the nine months ended September 30, 2017 and 2016, 6 thousand and 0 thousand performance-based stock units were canceled or forfeited. Under the terms of the 2016, 2015 and 2014 performance-based awards, once performance-based stock units are fully vested, participants are entitled to receive cash payments based on their initial performance grant values as target capital returns are exceeded. At September 30, 2017, the liability associated with such potential cash payments was \$0.0 million.

During the nine months ended September 30, 2017 and 2016, the Company issued 50 thousand and 43 thousand deferred stock units, respectively, 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.

During the nine months ended September 30, 2017 and 2016, the Company issued 7 thousand and 0 thousand restricted stock awards, respectively, and 3 thousand and 1 thousand restricted stock awards were canceled or forfeited, respectively.

Total compensation expense for performance-based stock units, deferred stock units, and restricted stock was \$0.5 million and \$0.5 million for the three months ended September 30, 2017 and 2016, respectively, and \$1.0 million and \$1.5 million for the nine months ended September 30, 2017 and 2016, respectively.

#### 7. Income Taxes

The Company's consolidated income tax benefit (expense) was \$0.0 million for the three and nine months ended September 30, 2017 and 2016. 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 benefit of the net operating loss that would have been recognized in the three and nine months ended September 30, 2017 was offset by changes in the valuation allowance. The tax expense that would have been recognized in the three and nine months ended September 30, 2016 was offset by changes in the valuation allowance. During the nine months ended September 30, 2017, the Company had no material changes in uncertain tax positions.

#### 8. Net Income (Loss) Per Share

The calculations of net income (loss) per share were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(Unaudited - In thousands, except per share data)			
Basic:				
Net loss	\$(18,650)	\$(24,085)	\$(69,844)	\$(561)
Weighted average common shares outstanding	20,455	20,387	20,416	20,390
Net loss per share	\$(0.91)	\$(1.18)	\$(3.42)	\$(0.03)

Diluted:

Net loss	\$(18,650)	\$(24,085)	\$(69,844)	\$(561 )
Weighted average common shares outstanding	20,455	20,387	20,416	20,390
Net loss for dilutive share computation	\$(0.91 )	\$(1.18 )	\$(3.42 )	\$(0.03)

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

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

If a consolidated or equity method partner company has dilutive stock options, unvested restricted stock, DSUs or warrants, diluted net income (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 income (loss). Any impact is shown as an adjustment to net income (loss) for purposes of calculating diluted net income (loss) per share.

Diluted earnings per share for the three and nine months ended September 30, 2017 and 2016 do not reflect the following potential shares of common stock that would have an anti-dilutive effect or have unsatisfied performance or market conditions:

At September 30, 2017 and 2016, options to purchase 0.6 million and 0.7 million shares of common stock, respectively, at prices ranging from \$9.83 to \$19.95 and \$9.83 to \$19.95, respectively, were excluded from the calculations.

At September 30, 2017 and 2016, unvested restricted stock, performance-based stock units and DSUs convertible into 0.9 million and 0.6 million shares of stock, respectively, were excluded from the calculations.

At September 30, 2017 and 2016, 2.3 million and 3.0 million shares of common stock representing the effect of the assumed conversion of the 2018 Debentures, were excluded from the calculations.

### 9. Segment Reporting

The Company operates as one operating segment based upon the similar nature of its technology-driven partner companies, the functional alignment of the organizational structure, and the reports that are regularly reviewed by the chief operating decision maker for the purpose of assessing performance and allocating resources. As of September 30, 2017, the Company held interests in 26 non-consolidated partner companies. The Company's active partner companies were as follows as of September 30, 2017:

Partner Company	Safeguard Primary Ownership as of September 30, 2017	Accounting Method
AdvantEdge Healthcare Solutions, Inc.	40.1%	Equity
Aktana, Inc.	24.5%	Equity
Apprenda, Inc.	29.4%	Equity
Brickwork	20.3%	Equity
Cask Data, Inc.	31.3%	Equity
CloudMine, Inc.	47.4%	Equity
Clutch Holdings, Inc.	42.7%	Equity
Full Measure Education, Inc.	42.3%	Equity
Hoopla Software, Inc.	25.5%	Equity
InfoBionic, Inc.	39.5%	Equity
Lumesis, Inc.	43.8%	Equity
MediaMath, Inc.	20.4%	Equity
meQuilibrium	37.0%	Equity
Moxe Health Corporation	32.4%	Equity
NovaSom, Inc.	31.7%	Equity
Prognos (fka Medivo, Inc.)	35.2%	Equity
Propeller Health, Inc.	24.0%	Equity
QuanticMind, Inc.	24.7%	Equity
Sonobi, Inc.	21.6%	Equity
Spongecell, Inc.	23.0%	Equity
Syapse, Inc.	26.0%	Equity
T-REX Group, Inc.	21.3%	Equity
Transactis, Inc.	23.8%	Equity
Trice Medical, Inc.	24.9%	Equity
WebLinc, Inc.	38.0%	Equity
Zipnosis, Inc.	25.4%	Equity



As of September 30, 2017 and December 31, 2016, all of the Company's assets were located in the United States.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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. 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, however, 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, 2017 which related to one of the Company's private equity holdings.

The Company is required to return a portion or all the distributions it received as a general partner of a private equity fund for further distribution to such fund's limited partners ("clawback"). The Company's ownership in the fund is 19%. The clawback liability is joint and several, such that 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. The Company was notified by the fund's manager that the fund is being dissolved and \$1.0 million of the Company's clawback liability was paid in the first quarter of 2017. The maximum additional clawback liability is \$0.3 million which was reflected in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2017.

In October 2001, the Company entered into an agreement with a former Chairman and Chief Executive Officer of the Company, 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 \$1.8 million was included in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2017.

The Company provided a \$6.3 million letter of credit that is scheduled to expire on March 31, 2019 to the landlord of CompuCom Systems, Inc.'s Dallas headquarters as required in connection with the sale of CompuCom Systems in 2004. The letter of credit is secured by cash which is classified as Long-term restricted cash equivalents on the Consolidated Balance Sheet.

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 \$3.0 million at September 30, 2017.

In June 2011, the Company's former partner company, Advanced BioHealing, Inc. ("ABH") was acquired by Shire plc ("Shire"). Prior to the expiration of the escrow period in March 2012, Shire filed a claim against all amounts held in escrow related to the sale based principally upon a United States Department of Justice ("DOJ") false claims act investigation relating to ABH (the "Investigation"). In connection with the Investigation, in July 2015 the Company received a Civil Investigation Demand-Documentary Material ("CID") from the DOJ regarding ABH and Safeguard's relationship with ABH. Pursuant to the CID, the Company provided the requested materials and information. To the Company's knowledge, the CID was related to multiple qui tam ("whistleblower") actions, one of which was filed in 2014 by an ex-employee of ABH that named the Company and one of the Company's employees along with other entities and individuals as defendants. At this time, the DOJ has declined to pursue the qui tam action as it relates to the Company and such Company employee. In addition, in connection with the above matters, the Company and other former equity holders in ABH recently entered into a settlement and release with Shire, which resulted in the release to Shire of all amounts held in escrow related to the sale of ABH.

11. Equity

In July 2015, the Company's Board of Directors authorized the Company, from time to time and depending on market conditions, to repurchase up to \$25.0 million of the Company's outstanding common stock. During the nine months ended September 30, 2016, the Company repurchased 0.4 million shares at an aggregate cost of \$5.4 million with

\$14.6 million remaining for repurchase under the existing authorization.

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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 and their performance, 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 be a nationally recognized leader with respect to entrepreneurship and innovation. Our vision is to provide capital and relevant expertise to fuel the growth of technology-driven businesses in healthcare, financial services and digital media. Throughout this document, we use the term "partner company" to generally refer to those companies in which we have an equity interest and in which we are actively involved, influencing development through board representation and management support, in addition to the influence we exert through our equity ownership. From time to time, in addition to these partner companies, we also hold relatively small equity interests in other enterprises where we do not exert significant influence and do not participate in management activities. In some cases, these interests relate to former partner companies and in some cases these interests relate to entities which may later become partner companies.

Safeguard targets technology-driven businesses in healthcare, financial services and digital media that are capitalizing on the next wave of enabling technologies with a particular focus, at present, on the Internet of Everything, enhanced security and predictive analytics. We strive to create long-term value for our shareholders by helping our partner companies to increase their market penetration, grow revenue and improve cash flow. Safeguard typically deploys between \$5 million and \$15 million of initial capital and \$5 million to \$10 million of follow-on funding with a total anticipated deployment of up to \$25 million in a company. We will occasionally provide certain early-stage seed round financings in amounts generally up to \$1 million to promising young companies with the goal to provide more capital once certain development milestones are achieved.



## Results of Operations

We operate as one operating segment based upon the similar nature of our technology-driven partner companies, the functional alignment of the organizational structure, and the reports that are regularly reviewed by the chief operating decision maker for the purpose of assessing performance and allocating resources.

There is intense competition in the markets in which our partner companies operate. 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 market.

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 influencing development, usually through board representation in addition to our equity ownership.

The following listing of our partner companies includes only entities which were considered partner companies as of September 30, 2017. Certain entities which may have been partner companies in previous periods are omitted if, as of September 30, 2017, they had been sold or are no longer considered a partner company.

Partner Company	Safeguard Primary Ownership as of		Accounting Method
	September 30,		
	2017	2016	
AdvantEdge Healthcare Solutions, Inc.	40.1%	40.1%	Equity
Aktana, Inc.	24.5%	23.4%	Equity
Apprenda, Inc.	29.4%	29.5%	Equity
Brickwork	20.3%	NA	Equity
Cask Data, Inc.	31.3%	31.3%	Equity
CloudMine, Inc.	47.4%	30.1%	Equity
Clutch Holdings, Inc.	42.7%	45.0%	Equity
Full Measure Education, Inc.	42.3%	36.0%	Equity
Hoopla Software, Inc.	25.5%	25.5%	Equity
InfoBionic, Inc.	39.5%	40.5%	Equity
Lumesis, Inc.	43.8%	44.1%	Equity
MediaMath, Inc.	20.4%	20.5%	Equity
meQuilibrium	37.0%	31.5%	Equity
Moxe Health Corporation	32.4%	32.6%	Equity
NovaSom, Inc.	31.7%	31.7%	Equity
Prognos (fka Medivo, Inc.)	35.2%	35.3%	Equity
Propeller Health, Inc.	24.0%	24.4%	Equity
QuanticMind, Inc.	24.7%	23.5%	Equity
Sonobi, Inc.	21.6%	21.6%	Equity
Spongecell, Inc.	23.0%	23.0%	Equity
Syapse, Inc.	26.0%	25.8%	Equity
T-REX Group, Inc.	21.3%	NA	Equity
Transactis, Inc.	23.8%	24.2%	Equity
Trice Medical, Inc.	24.9%	27.7%	Equity
WebLinc, Inc.	38.0%	38.0%	Equity
Zipnosis, Inc.	25.4%	26.2%	Equity

Three months ended September 30, 2017 versus the three months ended September 30, 2016

	Three months ended September 30,		
	2017	2016	Variance
	(In thousands)		
General and administrative expense	\$(3,758 )	\$(4,687 )	\$ 929
Other loss	(379 )	(2,405 )	2,026
Interest income	1,004	513	491
Interest expense	(2,643 )	(1,161 )	(1,482 )
Equity income (loss)	(12,874 )	(16,345 )	3,471
	\$(18,650)	\$(24,085)	\$ 5,435

**General and Administrative Expense.** Our general and administrative expenses consist primarily of employee compensation, insurance, travel-related costs, depreciation, office rent and professional services such as consulting, legal, and accounting. General and administrative expense also includes stock-based compensation expense which consists primarily of expense related to grants of stock options, restricted stock and deferred stock units to our employees and directors. General and administrative expense decreased \$0.9 million for the three months ended September 30, 2017 compared to the prior year period due to a decrease of \$0.7 million in employee costs and a decrease of \$0.1 million in professional fees.

**Other Loss.** Other loss decreased \$2.0 million for the three months ended September 30, 2017 compared to the prior year period. Other loss for the three months ended September 30, 2017 primarily reflected a \$0.4 million decrease in the fair value of shares of Invitae Corporation common stock obtained in connection with the sale of Good Start Genetics in August 2017. Other loss for the three months ended September 30, 2016 reflected a \$2.4 million impairment related to our Penn Mezzanine debt and equity participations.

**Interest Income.** Interest income includes all interest earned on available cash and marketable security balances as well as interest earned on notes receivable from our partner companies. The increase of \$0.5 million for the three months ended September 30, 2017 compared to the prior year period was primarily attributable to higher average notes receivable from our partner companies.

**Interest Expense.** Interest expense is primarily related to our credit facility and convertible senior debentures. The increase of \$1.5 million for the three months ended September 30, 2017 compared to the prior year period was primarily attributable to \$1.7 million of interest expense related to borrowings under the new credit facility we entered into in May 2017, partially offset by a \$0.2 million decrease in interest expense due to the repurchase, in aggregate, of \$14.0 million face value of convertible senior debentures in June and July 2017.

**Equity Loss.** Equity loss fluctuates with 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. We recognize our share of income or losses to the extent we have cost basis in the 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 decreased \$3.4 million for the three months ended September 30, 2017 compared to the prior year period. The components of equity loss for the three months ended September 30, 2017 and 2016 were as follows:

Three months ended September 30, 2017:

Gain on sale of Good Start Genetics	\$4,250
Unrealized dilution loss on the decrease of our percentage ownership in partner companies	(77 )
Loss on impairment of Pneuron	(206 )
Share of loss of our equity method partner companies	(16,841 )
	\$(12,874)

Three months ended September 30, 2016:

Loss on impairment of Aventura	\$(1,000 )
Gain on proceeds received from escrow related to sale of Quantia	600
Gain on additional proceeds received on the sale of Putney	430
Unrealized dilution gain on the decrease of our percentage ownership in partner companies	365
Share of loss of our equity method partner companies	(16,740 )
	\$(16,345)

The change in our share of equity loss of our equity method partner companies for the three months ended September 30, 2017 compared to the prior year period was primarily due to an increase in losses associated with those partner companies.

Nine months ended September 30, 2017 versus the nine months ended September 30, 2016

	Nine months ended September 30,		
	2017	2016	Variance
	(In thousands)		
General and administrative expense	\$(13,191)	\$(14,764)	\$1,573
Other loss	(219 )	(1,746 )	1,527
Interest income	2,892	1,460	1,432
Interest expense	(5,953 )	(3,465 )	(2,488 )
Equity income (loss)	(53,373 )	17,954	(71,327 )
	\$(69,844)	\$(561 )	\$(69,283)

**General and Administrative Expense.** General and administrative expense decreased \$1.6 million for the nine months ended September 30, 2017, compared to the prior year period primarily due to a decrease of \$1.1 million in stock-based compensation primarily for performance-based awards and a decrease of \$0.4 million in professional fees.

**Other Loss.** Other loss decreased \$1.5 million for the nine months ended September 30, 2017 compared to the prior year period. Other loss for the nine months ended September 30, 2017 reflected a \$0.4 million decrease in the fair value of shares of Invitae Corporation common stock obtained in connection with the sale of Good Start Genetics in August 2017 and an impairment of \$0.2 million related to our interest in a legacy private equity fund, partially offset by a \$0.4 million gain related to our Penn Mezzanine debt and equity participations. Other loss for the nine months ended September 30, 2016 reflected a \$2.1 million impairment related to our Penn Mezzanine debt and equity participations partially offset by a gain of \$0.4 million on the sale of Bridgevine in June 2016.

**Interest Income.** The increase of \$1.4 million for the nine months ended September 30, 2017 compared to the prior year period was primarily attributable to higher average notes receivable from our partner companies.

**Interest Expense.** The increase of \$2.5 million for the nine months ended September 30, 2017 compared to the prior year period was primarily attributable to \$2.6 million of interest expense related to borrowings under the new credit facility we entered into in May 2017, partially offset by a \$0.2 million decrease in interest expense due to the partial repurchase of \$14.0 million face value of convertible senior debentures in June and July 2017.

**Equity Income (Loss).** Equity income (loss) decreased \$71.3 million for the nine months ended September 30, 2017 compared to the prior year period. The components of equity income (loss) for the nine months ended September 30, 2017 and 2016 were as follows:



Nine months ended September 30, 2017:

Gain on sale of Good Start Genetics	\$4,250
Gain on proceeds received from escrow related to sale of Putney	704
Gain on proceeds received from escrow related to sale of Quantia	600
Gain on proceeds received from escrow related to the sale of AppFirst assets	141
Gain on sale of Nexxt (fka Beyond.com)	108
Unrealized dilution loss on the decrease of our percentage ownership in partner companies	(1,006 )
Loss on impairment of Spongecell	(3,550 )
Loss on impairment of Pneuron	(5,189 )
Share of loss of our equity method partner companies	(49,431 )
	\$(53,373)

Nine months ended September 30, 2016:

Gain on sale of Putney	\$55,638
Gain on performance milestone proceeds related to sale of Thingworx	3,264
Unrealized dilution gain on the decrease of our percentage ownership in partner companies	1,414
Gain on proceeds received from escrow related to sale of Drivefactor	1,100
Gain on proceeds received from escrow related to sale of Quantia	600
Loss on impairment of Aventura	(1,000 )
Loss on impairment of AppFirst	(1,731 )
Share of loss of our equity method partner companies	(41,331 )
	\$17,954

The change in our share of equity loss of our equity method partner companies for the nine months ended September 30, 2017 compared to the prior year period was due to an increase in losses associated with our partner companies.

Income Tax Benefit (Expense)

Income tax benefit (expense) was \$0.0 million for the three and nine months ended September 30, 2017 and 2016. 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 the three and nine months ended September 30, 2017 was offset by changes in the valuation allowance. The tax expense that would have been recognized in the three and nine months ended September 30, 2016 was offset by changes in the valuation allowance.

Liquidity and Capital Resources

As of September 30, 2017, we had \$34.3 million of cash and cash equivalents and \$5.4 million of marketable securities for a total of \$39.7 million. As of September 30, 2017, we had \$41.0 million of principal outstanding on our 2018 Debentures, which we anticipate repaying or refinancing by the maturity date of May 15, 2018.

In May 2017, we entered into a \$75.0 million secured, revolving credit facility (“Credit Facility”) with HPS Investment Partners, LLC (“Lender”). As of September 30, 2017, we had \$50.0 million of principal outstanding on the Credit Facility due in May 2020. The Credit Facility requires us to maintain (i) a liquidity threshold of at least \$20 million of unrestricted cash; (ii) a tangible net worth, plus unrestricted cash, of at least 1.75x the amount then outstanding under the Credit Facility; (iii) a minimum aggregate appraised value of our ownership interests in its partner companies, plus unrestricted cash in excess of the liquidity threshold, of at least \$350 million; and (iv) certain diversification requirements and concentration limits with respect to our capital deployments to its partner companies. As of the date these consolidated financial statements were issued, we were in compliance with all of these covenants.

We fund our operations with cash and marketable securities on hand as well as proceeds from the sales of our interest in our partner companies. Due to the nature of the mergers and acquisitions market, and the developmental cycle of companies like our partner companies, our ability to generate specific amounts of liquidity from sales of our partner company interests in any given period of time cannot be assured. Accordingly, the forecasts which we utilize for projecting future compliance with covenants related to our Credit Facility include significantly discounted probability-weighted proceeds from the sales of our interests in our partner companies. Based on these forecasts, we believe we will continue to remain in compliance with all of



our debt covenants. Our plans to remain in compliance with these covenants include selling certain of our partner company interests in the ordinary course of our business and limiting capital deployments to new and existing partner companies.

Non-compliance with any of the covenants would constitute an event of default under the Credit Facility, and the Lender could choose to accelerate the maturity of the indebtedness. If the Lender were to accelerate the maturity of the indebtedness, we may not have sufficient immediate liquidity to repay the entire balance of our outstanding borrowings and other obligations under the Credit Facility. Should we not be in compliance with any of our debt covenants and be unable to obtain waivers for such events of default, we would pursue one of a number of potential alternatives to satisfy the obligations, including completing an equity offering or obtaining a new debt facility to refinance its existing debt.

In November 2012, we issued \$55.0 million in face amount of our 5.25% convertible senior debentures due on May 15, 2018 (the "2018 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 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 our common stock at September 30, 2017 was \$13.35. 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 such 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 July and June 2017, we repurchased on the open market, and retired, an aggregate of \$14.0 million face value of 2018 Debentures at a cost of \$14.5 million, including transaction fees. In connection with the repurchase of these 2018 Debentures, we recognized a \$0.8 million reduction in equity which is included in Accumulated Paid-In Capital in the Consolidated Balance Sheet as of September 30, 2017 and a \$29 thousand loss on extinguishment of the liability which is included in Other income (loss), net in the Consolidated Statements of Operations for the nine months ended September 30, 2017. We had \$41.0 million face value of 2018 Debentures outstanding at September 30, 2017 due on May 15, 2018.

We have provided a \$6.3 million letter of credit that is scheduled to expire on March 31, 2019 to the landlord of CompuCom Systems, Inc.'s Dallas headquarters which was required in connection with the sale of CompuCom Systems in 2004. The letter of credit is secured by cash which is classified as Long-term restricted cash equivalents on the Consolidated Balance Sheet. The restriction on the cash will lapse when the related letter of credit is terminated or expires on March 31, 2019.

In July 2015, the Company's Board of Directors authorized us, from time to time and depending on market conditions, to repurchase up to \$25.0 million of the Company's outstanding common stock. During the year ended December 31, 2016, we repurchased 0.4 million shares at an aggregate cost of \$5.4 million with \$14.6 million remaining for repurchase under the existing authorization.

We are 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"). 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. We were notified by the fund's manager that the fund is being dissolved and \$1.0 million of our clawback liability was paid in the first quarter of 2017. The maximum additional clawback liability is \$0.3 million which was reflected in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2017.

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. Our ability to generate

liquidity from sales of partner companies, 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. 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.

## Analysis of Consolidated Cash Flows

Cash flow activity was as follows:

	Nine months ended September 30,		
	2017	2016	Variance
	(In thousands)		
Net cash used in operating activities	\$(15,515)	\$(14,114)	\$(1,401)
Net cash provided by (used in) investing activities	(1,912 )	39,593	(41,505 )
Net cash provided by (used in) financing activities	29,686	(5,821 )	35,507
	\$12,259	\$19,658	\$(7,399)

## Net Cash Used In Operating Activities

Net cash used in operating activities increased by \$1.4 million for the nine months ended September 30, 2017 compared to the prior year period. The increase was primarily due to \$1.2 million of cash interest payments related to our credit facility we entered into in May 2017.

## Net Cash Provided by (Used In) Investing Activities

Net cash provided by (used in) investing activities decreased by \$41.5 million for the nine months ended September 30, 2017 compared to the prior year period. The decrease primarily related to a \$57.3 million decrease in proceeds from the sales of and distributions from companies and a \$25.1 million decrease in cash proceeds from the net change in marketable securities, partially offset by a \$23.0 million decrease in acquisitions of ownership interests in companies and a \$0.8 million decrease in advances and loans to companies.

Cash proceeds from the sales of and distributions from companies were \$16.6 million for the nine months ended September 30, 2017 which related primarily to:

In March 2017, we sold our interest in partner company Nexxt, Inc., formerly Beyond.com, back to Nexxt, Inc. for \$26.0 million. We received \$15.5 million in cash and a three-year, \$10.5 million note for the balance due, which will accrue interest at a rate of 9.5% per annum.

In April 2017, we received \$0.7 million in connection with the expiration of the final escrow period related to the 2016 sale of Putney, Inc.

In March 2017, we received \$0.6 million of proceeds from the sale of our participating interests in Penn Mezzanine.

In January 2017, we received \$0.6 million in connection with the expiration of the final escrow period related to the 2015 sale of Quantia.

These cash proceeds were partially offset by payment of a \$1.0 million clawback liability in the first quarter of 2017. Cash proceeds from the sales of and distributions from partner companies was \$73.9 million for the nine months ended September 30, 2016 which related primarily to the sale of our interests in Putney and Bridgevine, proceeds received from AppFirst from the sale of its assets, cash received from escrow associated with the sale of our interests in DriveFactor, Thingworx, and Quantia and cash received associated with the achievement of performance milestones related to the sale of our interest in Thingworx.

## Net Cash Provided by (Used In) Financing Activities

Net cash provided by (used in) financing activities increased by \$35.5 million for the nine months ended September 30, 2017 compared to the prior year period. The increase was primarily related to \$44.3 million of net proceeds from borrowings under the Credit Facility and a decrease of \$5.4 million in repurchases of our common stock, which were partially offset by \$14.5 million paid to repurchase and retire \$14.0 million face value of the 2018 Debentures, including transaction fees.

**Contractual Cash Obligations and Other Commercial Commitments**

There have been no material changes to the contractual cash obligations and other commercial commitments we previously disclosed under Item 7 of Part II of our Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on March 3, 2017.

### 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 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 Credit Facility subjects us to interest rate risk.

In May 2017, we entered into a \$75.0 million secured, revolving credit facility (“Credit Facility”) with HPS Investment Partners, LLC (“Lender”). Debt service costs under the Credit Facility are subject to interest rate changes. Interest rates could rise from time to time and significantly increase our cost of borrowing. If that were to occur, replacing the Credit Facility with alternative credit arrangements having a lower cost of borrowing would likely not be possible and no assurance can be given that we would be able to refinance the Credit Facility on attractive terms or at all.

Servicing the indebtedness under the Credit Facility will require a significant amount of cash and our ability to generate cash depends on many factors beyond our control.

Our ability to make payments on the indebtedness under the Credit Facility will depend on our ability to generate cash in the future. We generate cash from proceeds we receive in connection with the sales of our interests in our partner companies. Due to the nature of the mergers and acquisitions market, and the developmental cycle of companies like our partner companies, our ability to generate specific amounts of liquidity from sales of our partner company interests in any given period of time cannot be assured. Our ability to generate cash is also, to a certain extent, subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. The risk exists that our business will be unable to generate sufficient cash flow to service our indebtedness under the Credit Facility.

Covenants in the agreements governing the Credit Facility could adversely affect our business and/or result in the operation of our business in a way other than as desired by management; our ability to comply with such covenants may be affected by events beyond our control; and a breach of any of these covenants could result in a default under

the agreements governing the Credit Facility, which, if not cured or waived, could result in the acceleration of the indebtedness under the Credit Facility.

The Credit Facility contains various covenants that prohibit or limit, subject to certain exceptions, our ability to, among other things:

• Sell, transfer, lease, convey or otherwise dispose of all or any part of our business or property;

• Exceed concentration limits with respect to the amount of capital deployed to any single partner company;



- Exceed concentration limits with respect to the amount of capital deployed to one or more partner companies operating in the same or similar industries;
- Deploy capital to partner companies operating outside of certain specified industries;
- Incur or assume liens or additional debt or provide guarantees in respect of obligations of other persons;
- Pay any dividends or make any distribution (in cash or in kind) or payment in respect of, or redeem, retire or purchase any capital stock;
- Enter into, or permit any of our subsidiaries to enter into, any sale and leaseback transaction;
- Wind-up, liquidate or dissolve, or merge, consolidate or amalgamate with any person, or permit any of our subsidiaries to do (or agree to do) so;
- Enter into certain transactions with affiliates; and
- Amend, modify or otherwise change any of our governing documents.

In addition, the Credit Facility requires us to among other things, maintain (i) a liquidity threshold of at least \$20 million of unrestricted cash; (ii) a tangible net worth, plus unrestricted cash, of at least 1.75x the amount then outstanding under the Credit Facility; and (iii) a minimum aggregate appraised value of the Company's ownership interests in its partner companies, plus unrestricted cash in excess of the liquidity threshold, of at least \$350 million. The foregoing covenants could adversely affect our ability to finance our operations, make strategic acquisitions, engage in business activities that may be in our interest and plan for or react to market conditions or otherwise execute our business strategies.

Our ability to comply with these covenants may be affected by events beyond our control, including prevailing economic, financial and industry conditions.

Our failure to comply with any of these covenants could result in a default under the Credit Facility. If that were to occur, the Lender could choose to accelerate the maturity of the indebtedness. If the Lender were to accelerate the maturity of the indebtedness, we may not have sufficient immediate liquidity to repay the entire balance of the outstanding borrowings and other obligations under the Credit Facility.

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.

A significant amount of our deployed capital may be concentrated in partner companies operating in the same or similar industries, limiting the diversification of our capital deployments.

Except as may be agreed to with our debt providers, we do not have fixed guidelines for diversification of capital deployments, and our capital deployments could be concentrated in several partner companies that operate in the same or similar industries. This may cause us to be more susceptible to any single economic, regulatory or other occurrence affecting those particular industries than we would otherwise be if our partner companies operated in more diversified industries.

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 raising additional

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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.

From time to time, we may hold equity interests in companies that are publicly traded. Fluctuations in the market prices of the common stock of publicly traded holdings may affect the price of our common stock. Historically, 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 capital providers for interests in companies could adversely affect our ability to deploy capital and result in higher valuations of partner company interests which 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. Competition from other capital providers could adversely affect our ability to deploy capital. In addition, 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. The trading volume and public float in the common stock of a publicly traded partner company may be small relative to our holdings. As a result, any significant open-market divestiture by us of our holdings in such a 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 and contractual restrictions also may adversely affect our ability to dispose of our partner company holdings on a timely basis.

Our success is dependent on our senior management.

Our success is dependent on our senior management team's ability to execute our strategy. A loss of one or more of the members of our senior 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 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

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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 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 stock price and 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 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 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 technologies, medical devices, financial services, healthcare diagnostics, etc.

Our partner companies' business strategies are often highly dependent upon the successful launch and commercialization of an innovative technology or device, including, without limitation, technologies or devices used in healthcare, financial services or digital media. Despite all of our efforts to understand the research and development underlying the innovation or creation of such technologies and devices 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 technology marketplaces 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.

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 retain 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. Further, if our partner companies do raise additional capital, either debt or equity, such capital may rank senior to our interests in such companies.

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 or a sale of the company, 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. If our partner companies raise additional capital, either debt or equity, that ranks senior to the capital we have deployed, such capital may entitle its holders to receive returns of capital before the dates on which we are entitled to receive any return of our deployed capital. Also, in the event of any insolvency, liquidation, dissolution, reorganization or bankruptcy of a partner company, holders of such partner company's instruments that rank senior to our deployed capital will typically be entitled to receive payment in full before we receive any return of our deployed capital. After returning such senior capital, such partner company may not have any remaining assets to use for returning capital to us, causing us to lose some or all of our deployed capital in such partner company.

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 current 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 payers 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. Compliance with such regulations could increase operating costs at certain of our partner companies, and the failure to comply could negatively affect the operations and results of some of our partner companies.

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.

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

There have been no material changes to the information we previously disclosed under Item 7A of Part II of our Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on March 3, 2017.

#### 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, 2017 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

Except as included under the heading "Factors That May Affect Future Results" above, there have been no material changes in our risk factors from the information set forth in our Annual Report on Form 10-K for the year ended December 31, 2016.

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

The following table provides information about purchases of equity securities by the Company and affiliated purchasers of the Company, during the quarter ended September 30, 2017, which equity securities are registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"):

Period	Total Number of Shares Purchased (a)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan (b)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan (b)
July 1, 2017 - July 31, 2017	1,062	\$12.6300	—	\$ 14,636,135
August 1, 2017 - August 31, 2017	163	\$11.8000	—	\$ 14,636,135
September 1, 2017 - September 30, 2017	2,258	\$12.9500	—	\$ 14,636,135
Total	3,483	\$12.7500	—	

(a) During the third quarter of 2017, the Company repurchased an aggregate of 3 thousand shares of its common stock initially issued as restricted stock awards to employees and subsequently withheld from employees to satisfy the statutory withholding tax liability upon the vesting of such restricted stock awards.

(b) In July 2015, our Board of Directors authorized the Company to repurchase shares of its outstanding common stock with an aggregate value of up to \$25.0 million. These repurchases may be made in open market or privately negotiated transactions, including under plans complying with Rule 10b5-1 of the Exchange Act, based on market conditions, stock price, and other factors. The share repurchase program does not obligate the Company to acquire any specific number of shares.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.

## 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. 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
31.1 †	<u>Certification of Stephen T. Zarrilli pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934.</u>
31.2 †	<u>Certification of Jeffrey B. McGroarty pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934.</u>
32.1 ‡	<u>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.</u>
32.2 ‡	<u>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.</u>
101	The following materials from Safeguard Scientifics, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets (unaudited); (ii) Consolidated Statements of Operations (unaudited); (iii) Consolidated Statements of Comprehensive Income (Loss) (unaudited); (iv) Condensed Consolidated Statements of Cash Flows (unaudited); (v) Consolidated Statement of Changes in Equity (unaudited); and (vi) Notes to Consolidated Financial Statements (unaudited).

† Filed herewith

‡ Furnished herewith

SIGNATURES

Pursuant to the requirements 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.

SAFEGUARD SCIENTIFICS, INC.

Date: October 26, 2017 /s/ Stephen T. Zarrilli

Stephen T. Zarrilli

President and Chief Executive Officer

Date: October 26, 2017 /s/ Jeffrey B. McGroarty

Jeffrey B. McGroarty

Senior Vice President and Chief Financial Officer