

SAFEGUARD SCIENTIFICS INC

Form 10-Q

October 24, 2014

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, 2014

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.)

435 Devon Park Drive

Building 800

Wayne, PA

(Address of principal executive offices)

(610) 293-0600

19087

(Zip Code)

Registrant's telephone number, including area code

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Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes " No þ

Number of shares outstanding as of October 23, 2014

Common Stock 20,535,769

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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, 2014	December 31, 2013
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 116,684	\$ 139,318
Marketable securities	35,217	38,250
Prepaid expenses and other current assets	1,494	1,562
Total current assets	153,395	179,130
Property and equipment, net	95	138
Ownership interests in and advances to partner companies and funds (of which \$0 and \$20,057 are measured at fair value at September 30, 2014 and December 31, 2013, respectively)	158,638	148,579
Loan participations receivable	4,184	8,135
Long-term marketable securities	13,840	6,088
Other assets	2,156	3,926
Total Assets	\$ 332,308	\$ 345,996
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Convertible senior debentures—current	\$ —	\$ 470
Accounts payable	261	245
Accrued compensation and benefits	3,070	5,028
Accrued expenses and other current liabilities	3,335	2,431
Total current liabilities	6,666	8,174
Other long-term liabilities	3,471	3,683
Convertible senior debentures—non-current	50,283	49,478
Total Liabilities	60,420	61,335
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 and 21,553 shares issued at September 30, 2014 and December 31, 2013, respectively	2,157	2,155
Additional paid-in capital	822,512	822,103
Treasury stock, at cost; 1,103 and 4 shares at September 30, 2014 and December 31, 2013, respectively	(23,149)	) —
Accumulated deficit	(529,632)	) (539,597 )
Total Equity	271,888	284,661
Total Liabilities and Equity	\$ 332,308	\$ 345,996
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,	
	2014	2013	2014	2013
General and administrative expense	\$4,177	\$4,835	\$14,485	\$16,924
Operating loss	(4,177	) (4,835	) (14,485	) (16,924
Other income (loss), net	(246	) (4,224	) 31,580	(6,191
Interest income	482	572	1,494	2,096
Interest expense	(1,103	) (1,077	) (3,295	) (3,220
Equity loss	(8,962	) (9,866	) (5,329	) (35,253
Net income (loss) before income taxes	(14,006	) (19,430	) 9,965	(59,492
Income tax benefit (expense)	—	—	—	—
Net income (loss)	\$(14,006	) \$(19,430	) \$9,965	\$(59,492
Net income (loss) per share:				
Basic	\$(0.68	) \$(0.90	) \$0.47	\$(2.80
Diluted	\$(0.68	) \$(0.90	) \$0.47	\$(2.80
Weighted average shares used in computing income (loss) per share :				
Basic	20,678	21,494	21,042	21,245
Diluted	20,678	21,494	21,418	21,245

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,	
	2014	2013	2014	2013
Net income (loss)	\$ (14,006 )	\$ (19,430 )	\$ 9,965	\$ (59,492 )
Other comprehensive income (loss), before taxes:				
Unrealized net gain (loss) on available-for-sale securities	(8 )	14	(12 )	(26 )
Reclassification adjustment for other than temporary impairment of available-for-sale securities included in net income (loss)	8	—	12	40
Total comprehensive income (loss)	\$ (14,006 )	\$ (19,416 )	\$ 9,965	\$ (59,478 )

See Notes to Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2014	2013
Cash Flows from Operating Activities:		
Net cash used in operating activities	\$(15,475 )	\$(16,299 )
Cash Flows from Investing Activities:		
Proceeds from sales of and distributions from companies and funds	81,626	2,603
Acquisitions of ownership interests in companies and funds	(54,956 )	(28,718 )
Advances and loans to companies	(9,868 )	(9,350 )
Repayment of advances and loans to companies	5,509	1,044
Origination fees on mezzanine loans	—	42
Increase in marketable securities	(44,578 )	(47,072 )
Decrease in marketable securities	39,979	129,664
Capital expenditures	(11 )	(37 )
Other	5	6,434
Net cash provided by investing activities	17,706	54,610
Cash Flows from Financing Activities:		
Issuance of Company common stock, net	612	4,397
Repurchase of convertible senior debentures	(441 )	(43 )
Repurchase of Company common stock	(25,036 )	—
Net cash provided by (used in) financing activities	(24,865 )	4,354
Net change in cash and cash equivalents	(22,634 )	42,665
Cash and cash equivalents at beginning of period	139,318	66,029
Cash and cash equivalents at end of period	\$116,684	\$108,694
See Notes to Consolidated Financial Statements.		



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

	Total	Accumulated Deficit	Common Stock		Additional Paid-in Capital	Treasury Stock	
			Shares	Amount		Shares	Amount
Balance - December 31, 2013	\$284,661	\$ (539,597 )	21,553	\$2,155	\$822,103	4	\$—
Net income	9,965	9,965	—	—	—	—	—
Stock options exercised, net	612	—	18	2	(842 )	(76 )	1,452
Issuance of restricted stock, net	74	—	—	—	(361 )	(19 )	435
Stock-based compensation expense	1,583	—	—	—	1,583	—	—
Repurchase of common stock	(25,036 )	—	—	—	—	1,194	(25,036 )
Conversion of 2014 Debentures to common stock	29	—	2	—	29	—	—
Balance - September 30, 2014	\$271,888	\$ (529,632 )	21,573	\$2,157	\$822,512	1,103	\$(23,149 )

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 2013 Annual Report on Form 10-K.

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

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

	September 30, 2014	December 31, 2013
	(Unaudited - In thousands)	
Fair value	\$—	\$20,057
Equity Method:		
Partner companies	141,073	108,872
Private equity funds	1,132	1,766
	142,205	110,638
Cost Method:		
Partner companies	6,050	13,480
Private equity funds	2,418	2,418
	8,468	15,898
Advances to partner companies	7,965	1,986
	\$158,638	\$148,579
Loan participations receivable	\$4,184	\$8,135
Available-for-sale securities	\$3	\$15

The Company’s share of the earnings or losses of partner companies, as well as any adjustments resulting from prior period finalizations of equity income or loss, are reflected in Equity income (loss) on the Consolidated Statements of Operations. In the nine months ended September 30, 2014, the amount related to prior periods was \$1.8 million, of which \$0.3 million related to 2012 and \$1.5 million related to 2013. The adjustments primarily related to a change in revenue recognition accounting at a partner company. Management evaluated the quantitative and qualitative impact of the corrections on previously reported periods as well as on the nine months ended September 30, 2014. Based on this evaluation, management concluded that these adjustments were not material to the Company’s Consolidated Financial Statements.

In April 2014, the Company sold its ownership interests in Sotera Wireless, Inc., formerly a cost method partner company. The Company received \$4.2 million in cash proceeds in connection with the transaction and recognized a gain of \$1.5 million, which is included in Other income (loss), net in the Consolidated Statements of Operations for

the nine months ended September 30, 2014.

In February 2014, Crescendo Bioscience, Inc., formerly a cost method partner company, was acquired by Myriad Genetics, Inc. The Company received \$38.4 million in cash proceeds in connection with the transaction, excluding \$2.9 million, net of claims paid through September 30, 2014, which will be held in escrow until approximately May 2015. The

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SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Company recognized a gain of \$27.4 million on the transaction, which is included in Other income (loss), net in the Consolidated Statements of Operations for the nine months ended September 30, 2014.

In February 2014, NuPathe Inc., formerly a fair value method partner company, was acquired by Teva Pharmaceutical Industries Ltd. for \$3.65 per share in cash. In addition to the upfront cash payment, NuPathe shareholders received rights to receive additional cash payments of up to \$3.15 per share if specified milestones are achieved over time. The Company received initial net cash proceeds of \$23.1 million as a result of the transaction. Depending on the achievement of certain milestones, the Company may receive up to an additional \$24.2 million. The Company recognized a gain of \$3.0 million, which is included in Other income (loss), net in the Consolidated Statements of Operations for the nine months ended September 30, 2014. For the three and nine months ended September 30, 2013, the Company recognized an unrealized loss of \$4.8 million and \$6.4 million, respectively, on the mark-to-market of its holdings in NuPathe, which is included in Other income (loss), net in the Consolidated Statements of Operations.

In January 2014, Alverix, Inc., formerly an equity method partner company, was acquired by Becton, Dickinson and Company. The Company received cash proceeds of \$15.7 million, excluding \$1.7 million which will be held in escrow until approximately July 2015. The Company recognized a gain of \$15.7 million on the transaction, which is included in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2014.

In the second quarter of 2014, the Company's primary ownership interest in Bridgevine, Inc. decreased from 22.7% to 17.3%. As a result, the Company recognized an unrealized loss of \$0.3 million which is reflected in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2014.

In the nine months ended September 30, 2014, the Company received cash proceeds of \$4.3 million from the repayment of loan participations receivable and \$1.3 million from the sale of an equity interest initiated by Penn Mezzanine. The Company recorded an impairment charge of \$0.3 million related to its Penn Mezzanine debt and equity participations in the nine months ended September 30, 2013, which is reflected in Other income (loss), net in the Consolidated Statements of Operations. The charge included \$0.2 million related to loan participations and \$0.1 million representing an adjustment to the fair value of the Company's participation in warrants.

The Company recognized an impairment charge of \$1.3 million related to PixelOptics Inc., formerly an equity method partner company, in the three months ended September 30, 2013 which is reflected in Equity income (loss) in the Consolidated Statements of Operations. The impairment was based on PixelOptics' inability to raise additional capital to continue its operations. The Company previously recorded an impairment charge of \$9.9 million in the second quarter of 2013. The adjusted carrying value of PixelOptics is \$0 and the Company believes it will not recover any of its capital. On November 4, 2013, PixelOptics filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.

The Company recognized an impairment charge of \$0.2 million related to its interest in a legacy private equity fund in the nine months ended September 30, 2013, which is reflected in Other income (loss), net in the Consolidated Statements of Operations.

For the nine months ended September 30, 2014, four partner companies accounted for under the equity method were considered significant. The following summarized statement of operations information for those partner companies for the nine months ended September 30, 2014 and 2013 have been compiled from the financial statements of the respective partner companies and reflect certain historical adjustments. Results of operations of the partner companies are excluded for periods prior to their acquisition. The results of the four partner companies are reported on a one quarter lag.

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	Nine Months Ended	
	September 30, 2014	September 30, 2013
Results of Operations:		
Revenue	\$125,645	\$67,074
Gross profit	\$75,490	\$47,112
Net loss	\$(37,541	) \$(15,702 )

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## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

In September and July 2014, the Company acquired a 31.9% interest in Trice Medical, Inc. for an aggregate of \$5.0 million. Trice Medical is a diagnostics company focused on micro invasive technologies specifically targeting orthopedics. The Company accounts for its interest in Trice Medical under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Trice Medical was preliminarily allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In August, July and April 2014, the Company funded an aggregate of \$4.3 million of convertible bridge loans to Quantia, Inc. The Company had previously deployed an aggregate of \$7.5 million in Quantia. Quantia provides a mobile and web-based physician relationship management platform, QuantiaMD, which enables principal participants throughout the healthcare spectrum, including health systems, payers, pharmaceutical companies and medical device companies, to engage and interact with their physicians. The Company accounts for its interest in Quantia under the equity method.

In August 2014, the Company acquired a 24.6% interest in Propeller Health, Inc. for \$9.0 million. Propeller Health provides digital solutions to improve respiratory health. The Company accounts for its interest in Propeller Health under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Propeller Health was preliminarily allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In August 2014, the Company acquired a 24.8% interest in Transactis, Inc. for \$9.5 million. Transactis is a provider of electronic billing and payment solutions. The Company accounts for its interest in Transactis under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Transactis was preliminarily allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In August 2014, the Company acquired a 29.2% interest in WebLinc, Inc. for \$6.0 million. WebLinc is a commerce platform provider for fast growing online retailers. The Company accounts for its interest in WebLinc under the equity method. The difference between the Company's cost and its interest in the underlying net assets of WebLinc was preliminarily allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In June 2014, the Company acquired a 27.0% interest in Syapse, Inc. for \$5.8 million. Syapse provides a precision medicine data platform that enables laboratories, registries, and hospitals to use molecular profiling to diagnose and treat patients. The Company accounts for its interest in Syapse under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Syapse was preliminarily allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In June and April 2014, the Company deployed an aggregate of \$5.0 million into Putney, Inc. The Company had previously deployed \$10.0 million in Putney. Putney is a specialty pharmaceutical company focused on providing generic medicines for pets. The Company accounts for its interest in Putney under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Putney was allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In May and January 2014, the Company deployed an aggregate of \$1.7 million into Lumesis, Inc. The Company had previously deployed an aggregate of \$3.9 million in Lumesis. Lumesis is a financial technology company that is dedicated to delivering software solutions and comprehensive, timely data to the municipal bond marketplace. The Company accounts for its interest in Lumesis under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Lumesis was allocated to goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In May 2014, the Company funded \$0.1 million into New York Digital Health Accelerator II in exchange for a 12.5% limited partnership interest in the fund which is run by the New York eHealth Collaborative and the New York City Investment Fund for early- and growth-stage digital health companies that are developing technology products in care coordination, patient engagement, analytics and message alerts for healthcare providers. The Company accounts for its interest in New York Digital Health Accelerator II under the equity method.

In May 2014, the Company deployed an additional \$2.0 million into Clutch Holdings, Inc. ("Clutch"). The Company had previously deployed an aggregate of \$5.5 million in Clutch. Clutch is a provider of loyalty and gift card programs to retailers through its proprietary platform, and offers a mobile wallet application to consumers to track and store gift and loyalty cards, coupons and other retail shopping tools. The Company accounts for its interest in Clutch under the equity method. The

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

difference between the Company's cost and its interest in the underlying net assets of Clutch was allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In May 2014, the Company funded \$1.1 million of a convertible bridge loan to NovaSom, Inc. The Company had previously deployed \$20.0 million in NovaSom. NovaSom provides diagnostic devices and services for home testing and evaluation of sleep-disordered breathing, including obstructive sleep apnea. The Company accounts for its interest in NovaSom under the equity method.

In May 2014, the Company deployed an additional \$0.8 million into Dabo Health, Inc. ("Dabo"). The Company had previously deployed \$0.8 million in Dabo. Dabo provides the healthcare community with a healthcare information platform that brings clarity to quality metrics, makes them actionable to hospitals and care providers, and facilitates collaboration for quality improvement. The Company accounts for its interest in Dabo under the cost method.

In May 2014, the Company deployed an additional \$7.0 million into MediaMath, Inc. In connection with the May 2014 financing, the Company's primary ownership interest decreased from 22.5% to 20.6%. As a result, the Company recognized an unrealized gain of \$7.0 million which is reflected in Equity income (loss) in the Consolidated Statements of Operations. The Company had previously deployed an aggregate of \$18.6 million in MediaMath. MediaMath is an online media trading company that enables advertising agencies and their advertisers to optimize their ad spending across various exchanges through its proprietary algorithmic bidding platform and data integration technology. The Company accounts for its interest in MediaMath under the equity method.

In May 2014, the Company funded \$2.1 million of a convertible bridge loan to AppFirst, Inc. The Company had previously deployed \$6.5 million in AppFirst. AppFirst delivers application monitoring systems for development operations professionals and technology executives with visibility into systems, applications and business metrics. The Company accounts for its interest in AppFirst under the equity method.

In March 2014, the Company acquired a 20.4% interest in InfoBionic Inc. for \$4.0 million. 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. The difference between the Company's cost and its interest in the underlying net assets of InfoBionic was preliminarily allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In March 2014, the Company funded \$0.2 million of a convertible bridge loan to Sotera Wireless, Inc. The Company previously deployed \$1.3 million into Sotera Wireless and acquired additional shares from a previous investor for \$1.2 million. In April 2014, the Company sold its equity and debt interests in Sotera Wireless for \$4.2 million. The Company accounted for its interest in Sotera Wireless under the cost method.

In January 2014, the Company deployed an additional \$1.4 million into Hoopla Software, Inc. ("Hoopla"). The Company had previously deployed an aggregate of \$1.8 million in Hoopla. Hoopla helps organizations create high performance sales cultures through software-as-a-service solutions that integrate with customer relationship management systems. The Company accounts for its interest in Hoopla under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Hoopla was preliminarily allocated to intangible assets and goodwill and is reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.



## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 4. Fair Value Measurements

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

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

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

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

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

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, 2014 and December 31, 2013:

	Carrying Value	Fair Value Measurement at September 30, 2014		
		Level 1	Level 2	Level 3
	(Unaudited - In thousands)			
Cash and cash equivalents	\$116,684	\$116,684	\$—	\$—
Available-for-sale securities	3	3	—	—
Warrant participations	71	—	—	71
Marketable securities—held-to-maturity:				
Commercial paper	\$6,592	\$6,592	\$—	\$—
U.S. treasury bills	1,504	1,504	—	—
Government agency bonds	13,503	13,503	—	—
Certificates of deposit	27,458	27,458	—	—
Total marketable securities	\$49,057	\$49,057	\$—	\$—
		Fair Value Measurement at December 31, 2013		
	(Unaudited - In thousands)			
Cash and cash equivalents	\$139,318	\$139,318	\$—	\$—
Restricted marketable securities	5	5	—	—
Ownership interest in common stock of NuPathe	16,874	16,874	—	—
Ownership interest in warrants and options of NuPathe	3,183	—	—	3,183
Available-for-sale securities	15	15	—	—
Warrant participations	1,563	—	—	1,563
Marketable securities—held-to-maturity:				
Commercial paper	\$13,599	\$13,599	\$—	\$—
U.S. treasury bills	8,014	8,014	—	—
Government agency bonds	9,945	9,945	—	—
Certificates of deposit	12,780	12,780	—	—
Total marketable securities	\$44,338	\$44,338	\$—	\$—

As of September 30, 2014, \$35.2 million of marketable securities had contractual maturities which were less than one year and \$13.8 million of marketable securities had contractual maturities greater than one year. Held-to-maturity securities are carried at amortized cost, which, due to the short-term maturity of these instruments, approximates fair value using quoted prices in active markets for identical assets or liabilities defined as Level 1 inputs under the fair

value hierarchy.

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## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company recorded an impairment charge of \$11.2 million related to PixelOptics, formerly an equity method partner company, in the nine months ended September 30, 2013 measured as the amount by which PixelOptics' carrying value exceeded its estimated fair value. The carrying value of the Company's equity ownership in PixelOptics is \$0 and the Company believes it will not recover any of its capital. On November 4, 2013, PixelOptics filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.

The Company's Penn Mezzanine warrant participations are carried at fair value. The value of the Company's holdings in warrant participations is measured by reference to Level 3 inputs. The inputs and valuation techniques used include discounted cash flows and valuation of comparable public companies. The Company recorded an impairment charge of \$0.3 million related to its Penn Mezzanine debt and equity participations in the nine months ended September 30, 2013 measured as the amount by which the carrying value of the Company's participation in the debt, equity and warrant interests acquired by Penn Mezzanine exceeded their estimated fair values.

The Company recognized an impairment charge of \$0.2 million related to its interest in a legacy private equity fund in the nine months ended September 30, 2013 measured as the amount by which the carrying value of the Company's interest in the fund exceeded its estimated fair value. The fair market value of the Company's interest in the fund was determined to be \$1.7 million based on the fair value of the Company's pro rata portion of the fund's net assets, which is a Level 3 input under the fair value hierarchy.

#### 5. Convertible Debentures and Credit Arrangements

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

	September 30, 2014	December 31, 2013
	(Unaudited - In thousands)	
Convertible senior debentures due 2018	\$50,283	\$49,478
Convertible senior debentures due 2024	—	441
Convertible senior debentures due 2014	—	29
	50,283	49,948
Less: current portion	—	(470)
Convertible senior debentures – non current	\$50,283	\$49,478

#### Convertible Senior Debentures due 2018

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

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

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

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

if the notes have been called for redemption; or

upon the occurrence of specified corporate events.

On or after November 15, 2017, until the close of business on the second business day immediately preceding the maturity date, holders may convert their notes at any time, regardless of whether any of the foregoing conditions has been met. Upon conversion, the Company will satisfy its conversion obligation by paying or delivering, as the case

may be, cash, shares of common stock or a combination of cash and shares of our common stock, at the Company's election.

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## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The conversion rate of the 2018 Debentures is 55.17 shares of common stock per \$1,000 principal amount of debentures, equivalent to a conversion price of approximately \$18.13 per share of common stock. The closing price per share of the Company's common stock at September 30, 2014 was \$18.40.

On or after November 15, 2016, the Company may redeem for cash any of the 2018 Debentures if the last reported sale price of the Company's common stock exceeds 140% of the conversion price for at least 20 trading days during the period of 30 consecutive trading days ending on the trading day before the date that notice of redemption is given, including the last trading day of such period. Upon any redemption of the 2018 Debentures, the Company will pay a redemption price of 100% of their principal amount, plus accrued and unpaid interest to, but excluding, the date of redemption, and additional interest, if any.

The 2018 Debenture holders have the right to require the Company to repurchase the 2018 Debentures if the Company undergoes a fundamental change, which includes the sale of all or substantially all of the Company's common stock or assets; liquidation; dissolution; a greater than 50% change in control; the delisting of the Company's common stock from the New York Stock Exchange or the NASDAQ Global Market (or any of their respective successors); or a substantial change in the composition of the Company's board of directors as defined in the governing agreement.

Holder may require that the Company repurchase for cash all or part of their 2018 Debentures at a fundamental change repurchase price equal to 100% of the principal amount of the debentures to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

Because the 2018 Debentures may be settled in cash or partially in cash upon conversion, the Company separately accounts for the liability and equity components of the 2018 Debentures. The carrying amount of the liability component was determined at the transaction date by measuring the fair value of a similar liability that does not have an associated equity component. The carrying amount of the equity component represented by the embedded conversion option was determined by deducting the fair value of the liability component from the initial proceeds of the 2018 Debentures as a whole. At September 30, 2014, the fair value of the \$55.0 million outstanding 2018 Debentures was approximately \$68.5 million, based on the midpoint of the bid and ask prices as of such date. At September 30, 2014, the carrying amount of the equity component was \$6.4 million, the principal amount of the liability component was \$55.0 million, the unamortized discount was \$4.7 million and the net carrying value of the liability component was \$50.3 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 \$0.8 million and \$0.7 million of such expense for the nine months ended September 30, 2014 and 2013, respectively. The effective interest rate on the 2018 Debentures is 8.7%.

#### Convertible Senior Debentures due 2024

In 2004, the Company issued an aggregate of \$150.0 million in face value of convertible senior debentures with a stated maturity date of March 15, 2024 (the "2024 Debentures") of which approximately \$0.4 million remained outstanding as of December 31, 2013. The Company repurchased or redeemed all of the remaining 2024 Debentures in the second quarter of 2014.

#### Convertible Senior Debentures due 2014

In 2010, the Company issued an aggregate of \$46.9 million of the 2014 Debentures. In November 2012, the Company repurchased substantially all of the 2014 Debentures for \$58.7 million plus accrued interest. The remaining \$29 thousand outstanding principal amount of the 2014 Debentures was converted into the Company's common stock in March 2014.

#### Credit Arrangements

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

and the lesser of \$80 million or 75% of its investment and securities accounts at the bank. The credit facility, as amended, matures on December 31, 2014. Under the credit facility, the Company provided a \$6.3 million letter of credit expiring on March 19, 2019 to the landlord of CompuCom Systems, Inc.'s Dallas headquarters which was required in connection with the sale of CompuCom Systems in 2004. Availability under the Company's revolving credit facility at September 30, 2014 was \$43.7 million.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 6. Stock-Based Compensation

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2014	2013	2014	2013
	(Unaudited - In thousands)			
General and administrative expense	\$ 176	\$ 510	\$ 1,583	\$ 1,808
	\$ 176	\$ 510	\$ 1,583	\$ 1,808

The fair value of the Company's stock-based awards to employees was estimated at the date of grant using the Black-Scholes option-pricing model. The risk-free rate was based on the U.S. Treasury yield curve in effect at the end of the quarter in which the grant occurred. The expected term of stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility measured using weekly price observations of the Company's common stock for a period equal to the stock option's expected term. At September 30, 2014, the Company had outstanding options that vest based on three different types of vesting schedules:

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

Market-based awards entitle participants to vest in a number of options determined by achievement by the Company of certain target market capitalization increases (measured by reference to stock price increases on a specified number of outstanding shares) over an eight-year period. The requisite service periods for the market-based awards are based on the Company's estimate of the dates on which the market conditions will be met as determined using a Monte Carlo simulation model. Compensation expense is recognized over the requisite service periods using the straight-line method but is accelerated if market capitalization targets are achieved earlier than estimated. During the nine months ended September 30, 2014 and 2013, respectively, the Company did not issue any market-based option awards to employees. During the nine months ended September 30, 2014 and 2013, 22 thousand and 0 options, respectively, vested based on achievement of market capitalization targets. During the nine months ended September 30, 2014, 107 thousand unvested market-based awards expired by their terms. The Company recorded compensation expense related to market-based option awards of \$0.0 million for both the three months ended September 30, 2014 and 2013, and \$0.0 million and \$0.2 million for the nine months ended September 30, 2014 and 2013, respectively. Depending on the Company's stock performance, the maximum number of unvested shares at September 30, 2014 attainable under these grants was 273 thousand shares.

Performance-based awards entitle participants to vest in a number of awards determined by achievement by the Company of target capital returns based on net cash proceeds received by the Company on the sale, merger or other exit transaction of certain identified partner companies. Vesting may occur, if at all, once per year. The requisite service periods for the performance-based awards are based on the Company's estimate of when the performance conditions will be met. Compensation expense is recognized for performance-based awards for which the performance condition is considered probable of achievement. Compensation expense is recognized over the requisite service periods using the straight-line method but is accelerated if capital return targets are achieved earlier than estimated. During the nine months ended September 30, 2014 and 2013, the Company did not issue any performance-based awards to employees. During the nine months ended September 30, 2014 and 2013, respectively, 7 thousand and 0 performance-based awards vested. During the nine months ended September 30, 2014 and 2013, respectively, 16 thousand and 13 thousand performance based awards were canceled or forfeited. The Company recorded compensation expense related to performance-based option awards of \$0.0 million and \$0.1 million for the three months ended September 30, 2014 and 2013, respectively, and \$0.1 million and \$0.3 million for the nine months ended September 30, 2014 and 2013, respectively. The maximum number of unvested shares at September 30, 2014

attainable under these option grants was 429 thousand shares.

All other outstanding options are service-based awards that generally vest over four years after the date of grant and expire eight years after the date of grant. Compensation expense is recognized over the requisite service period using the straight-line method. The requisite service period for service-based awards is the period over which the award vests. During the nine months ended September 30, 2014 and 2013, respectively, the Company issued 5 thousand and 39 thousand service-based option awards to employees. The Company recorded compensation expense related to service-based option awards of \$0.1 million and \$0.2 million for the three months ended September 30, 2014 and 2013, respectively, and \$0.3 million and \$0.4 million for the nine months ended September 30, 2014 and 2013, respectively.



SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the nine months ended September 30, 2014 and 2013, respectively, the Company issued 45 thousand and 46 thousand deferred stock units to non-employee directors for annual service grants or fees earned during the preceding quarter. Deferred stock units issued to directors in lieu of directors fees are 100% vested at the grant date; matching deferred stock units equal to 25% of directors' fees deferred vest one year following the grant date or, if earlier, upon reaching age 65. Deferred stock units are payable in stock on a one-for-one basis. Payments related to the deferred stock units are generally distributable following termination of employment or service, death or permanent disability. Total compensation expense for deferred stock units, performance-based stock units and restricted stock was approximately \$0.1 million and \$0.3 million for the three months ended September 30, 2014 and 2013, respectively, and \$1.2 million and \$1.0 million for the nine months ended September 30, 2014 and 2013, respectively.

In May 2014, the Company's shareholders approved an amendment and restatement of the 2004 Equity Compensation Plan to increase the number of shares of common stock reserved for issuance by 2.2 million shares, to rename the plan the 2014 Equity Compensation Plan, and to make certain other clarifying changes and updates to the plan.

#### 7. Income Taxes

The Company's consolidated income tax benefit (expense) was \$0.0 million for the three and nine months ended September 30, 2014 and 2013. The Company has recorded a valuation allowance to reduce its net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the tax expense that would have been recognized in the nine months ended September 30, 2014 was offset by changes in the valuation allowance. The benefit of the net operating loss that would have been recognized in the three months ended September 30, 2014 and 2013 and the nine months ended September 30, 2013 was also offset by changes in the valuation allowance.

During the nine months ended September 30, 2014, the Company had no material changes in uncertain tax positions.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 8. Net Income (Loss) Per Share

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

	Three months ended September 30, 2014		2013		Nine months ended September 30, 2014		2013	
	(Unaudited - In thousands, except per share data)							
Basic:								
Net income (loss)	\$ (14,006	)	\$ (19,430	)	\$ 9,965		\$ (59,492	)
Weighted average common shares outstanding	20,678		21,494		21,042		21,245	
Net income (loss) per share	\$ (0.68	)	\$ (0.90	)	\$ 0.47		\$ (2.80	)
Diluted:								
Net income (loss) for dilutive share computation	\$ (14,006	)	\$ (19,430	)	\$ 9,965		\$ (59,492	)
Number of shares used in basic per share computation	20,678		21,494		21,042		21,245	
Unvested restricted stock and DSUs	—		—		354		—	
Employee stock options	—		—		22		—	
Weighted average common shares outstanding	20,678		21,494		21,418		21,245	
Net income (loss) per share	\$ (0.68	)	\$ (0.90	)	\$ 0.47		\$ (2.80	)

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).

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 months ended September 30, 2014 and 2013 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, 2014 and 2013, options to purchase 1.7 million and 2.3 million shares of common stock at prices ranging from \$3.93 to \$18.80 for both periods were excluded from the calculations.

At both September 30, 2014 and 2013, unvested restricted stock, performance stock units and DSUs convertible into 0.3 million shares of stock were excluded from the calculations.

At September 30, 2014 and 2013, 3.0 million shares of common stock, representing the effect of the assumed conversion of the 2018 Debentures, were excluded from the calculation.

Diluted earnings per share for the nine months ended September 30, 2014 and 2013 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, 2014 and 2013, options to purchase 0.8 million and 2.3 million shares of common stock at prices ranging from \$7.41 to \$18.78 and \$3.93 to \$18.80, respectively, were excluded from the calculations.

At both September 30, 2014 and 2013, unvested restricted stock, performance stock units and DSUs convertible into 0.3 million shares of stock were excluded from the calculations.

At both September 30, 2014 and 2013, 3.0 million shares of common stock, representing the effect of the assumed conversion of the 2018 Debentures, were excluded from the calculation.



## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 9. Operating Segments

As of September 30, 2014, the Company held interests in 24 non-consolidated partner companies which are included in the Healthcare and Technology segments. Included in the Penn Mezzanine segment are the Company's interests in the Penn Mezzanine management company and general partner and the Company's participations in mezzanine loans and equity interests initiated by Penn Mezzanine.

The Company's active partner companies by segment were as follows as of September 30, 2014:

## Healthcare

Partner Company	Safeguard Primary Ownership as of September 30, 2014	Accounting Method
AdvantEdge Healthcare Solutions, Inc.	40.1%	Equity
Dabo Health, Inc.	12.9%	Cost
Good Start Genetics, Inc.	29.9%	Equity
InfoBionic Inc.	18.0%	Equity (1)
Medivo, Inc.	34.5%	Equity
NovaSom, Inc.	30.3%	Equity
Propeller Health, Inc.	24.4%	Equity
Putney, Inc.	28.3%	Equity
Quantia, Inc.	42.3%	Equity
Syapse, Inc.	27.0%	Equity
Trice Medical, Inc.	31.9%	Equity

## Technology

Partner Company	Safeguard Primary Ownership as of September 30, 2014	Accounting Method
AppFirst, Inc.	34.3%	Equity
Apprenda, Inc.	21.6%	Equity
Beyond.com, Inc.	38.2%	Equity
Bridgevine, Inc.	17.2%	Cost (2)
Clutch Holdings, Inc.	29.6%	Equity
DriveFactor, Inc.	40.6%	Equity
Hoopla Software, Inc.	25.6%	Equity
Lumesis, Inc.	48.5%	Equity
MediaMath, Inc.	20.5%	Equity
Pneuron Corporation	27.6%	Equity
Spongecell, Inc.	23.0%	Equity
Transactis, Inc.	24.8%	Equity
WebLinc, Inc.	29.2%	Equity

(1) The decrease in the Company's primary ownership below 20.0% in the third quarter of 2014 is considered temporary because the Company expects to deploy additional capital in InfoBionic in the fourth quarter of 2014. Accordingly, the Company continues to exercise significant influence over InfoBionic and account for it under the equity method.

(2) In the second quarter of 2014, the Company's ownership interest in Bridgevine decreased from 22.7% to 17.3%, below the threshold at which the Company believes it exercises significant influence. Accordingly, the Company changed its method of accounting for Bridgevine from the equity method to the cost method at such time.

As of September 30, 2014, the Company has a 36% ownership interest in the management company and general partner of Penn Mezzanine L.P., which is included in the Penn Mezzanine segment. The Company accounts for its interest under the equity method.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

Other Items include certain expenses which are not identifiable to the operations of the Company's operating business segments. Other Items primarily consist of general and administrative expenses related to corporate operations, including employee compensation, insurance and professional fees, including legal and finance, interest income, interest expense and other income (loss) and equity income (loss) related to certain private equity fund ownership interests. Other Items also include income taxes, which are reviewed by management independent of segment results.

As of September 30, 2014 and December 31, 2013, all of the Company's assets were located in the United States. Segment assets in Other Items included primarily cash, cash equivalents, and marketable securities of \$165.7 million and \$183.7 million, at September 30, 2014 and December 31, 2013, respectively.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Three months ended September 30, 2014				
	Healthcare Technology	Penn Mezzanine	Total Segments	Other Items	Total
	(Unaudited - In thousands)				
Operating loss	\$—	\$—	\$(3)	\$(4,174)	\$(4,177)
Other income (loss), net	(8)	—	(238)	—	(246)
Interest income	—	—	307	175	482
Equity income (loss)	(4,734)	(4,109)	(158)	39	(8,962)
Net loss	(4,742)	(4,109)	(92)	(5,063)	(14,006)
Segment Assets:					
September 30, 2014	62,066	93,025	6,490	170,727	332,308
December 31, 2013	74,939	69,471	12,783	188,803	345,996
	Three months ended September 30, 2013				
	Healthcare Technology	Penn Mezzanine	Total Segments	Other Items	Total
	(Unaudited - In thousands)				
Operating loss	\$—	\$—	\$(4)	\$(4,831)	\$(4,835)
Other income (loss), net	(4,772)	—	547	1	(4,224)
Interest income	—	—	394	178	572
Equity income (loss)	(6,553)	(3,490)	(92)	269	(9,866)
Net income (loss)	(11,325)	(3,490)	845	(5,460)	(19,430)
	Nine months ended September 30, 2014				
	Healthcare Technology	Penn Mezzanine	Total Segments	Other Items	Total
	(Unaudited - In thousands)				
Operating loss	\$—	\$—	\$(8)	\$(14,477)	\$(14,485)
Other income (loss), net	31,823	—	(243)	—	31,580
Interest income	—	—	1,087	407	1,494
Equity income (loss)	1,341	(6,108)	(596)	34	(5,329)
Net income (loss)	33,164	(6,108)	240	(17,331)	9,965
	Nine months ended September 30, 2013				
	Healthcare Technology	Penn Mezzanine	Total Segments	Other Items	Total
	(Unaudited - In thousands)				
Operating loss	\$—	\$—	\$(13)	\$(16,911)	\$(16,924)
Other income (loss), net	(6,362)	—	324	(153)	(6,191)
Interest income	—	—	1,118	978	2,096
Equity income (loss)	(27,303)	(7,990)	(256)	296	(35,253)
Net income (loss)	(33,665)	(7,990)	1,173	(19,010)	(59,492)

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, 2014 which related to one of the Company's private equity holdings.

The Company also has committed capital of approximately \$0.2 million to other private equity funds. These commitments are expected to be funded during the next 12 months.

Under certain circumstances, the Company may be required to return a portion or all the distributions it received as a general partner of a private equity fund ("clawback"). The maximum clawback the Company could be required to return due to its general partner interest is approximately \$1.3 million, of which \$1.0 million was reflected in Accrued expenses and other current liabilities and \$0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheets at September 30, 2014. The Company's ownership in the fund is 19%. The clawback liability is joint and several; therefore the Company may be required to fund the clawback for other general partners should they default. The Company believes its potential liability due to the possibility of default by other general partners is remote.

In 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 \$2.5 million was included in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2014.

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

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, 2014.

#### 11. Equity

In February 2014, 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, 2014, the Company repurchased 1.2 million shares at an aggregate cost of \$25.0 million. This share repurchase program was completed in May 2014.



## 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 build value in growth-stage businesses by providing capital as well as strategic, operational and management resources. Safeguard participates principally in growth and expansion financings and early-stage financings. Our vision is to be the preferred capital source for entrepreneurs and management teams in well defined industry sectors. 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 they relate to entities which may later become partner companies.

We strive to create long-term value for our shareholders by helping our partner companies increase their market penetration, grow revenue and improve cash flow. Safeguard focuses principally on companies with initial capital requirements of between \$5 million and \$15 million, and follow-on financing needs of between \$5 million and \$10 million, with a total anticipated deployment up to \$25 million from Safeguard. We will occasionally provide certain early stage financing in amounts generally up to \$1 million to promising young companies with the goal to provide more capital once certain development milestones are achieved. Safeguard principally targets companies that operate in two sectors:

Healthcare — companies focused on medical technology ("MedTech"), including diagnostics and devices; healthcare technology ("HealthTech"); and specialty pharmaceuticals. Within these areas, Safeguard targets companies that have

lesser regulatory risk and have achieved or are near commercialization; and

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

Principles of Accounting for Ownership Interests in Partner Companies

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

**Consolidation Method.** We account for partner companies in which we maintain a controlling financial interest, generally those in which we directly or indirectly own more than 50% of the outstanding voting securities, using the consolidation method of accounting. Upon consolidation of our partner companies, we reflect the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to the parent company as a non-controlling interest in the Consolidated Balance Sheet. The non-controlling interest is presented within equity, separately from the equity of the parent company. Losses attributable to the parent company and the non-controlling interest may exceed their interest in the subsidiary's equity. As a result, the non-controlling interest shall continue to be attributed its share of losses even if that attribution results in a deficit non-controlling interest balance as of each balance sheet date. Revenue, expenses, gains, losses, net income or loss are reported in the Consolidated Statements of Operations at the consolidated amounts, which include the amounts attributable to the parent company's common shareholders and the non-controlling interest. As of September 30, 2014, we did not hold a controlling interest in any of our partner companies.

**Fair Value Method.** Unrealized gains and losses on the mark-to-market of our holdings in fair value method companies and realized gains and losses on the sale of any holdings in fair value method companies are recognized in Other income (loss), net in the Consolidated Statements of Operations. We accounted for our holdings in NuPathe Inc., a former publicly traded partner company, under the fair value method of accounting. As of September 30, 2014, we did not account for any of our partner companies under the fair value method.

**Equity Method.** We account for partner companies whose results are not consolidated, but over whom we exercise significant influence, using the equity method of accounting. We also account for our interests in some private equity funds under the equity method of accounting, based on our non-controlling general and limited partner interests. Under the equity method of accounting, our share of the income or loss of the partner company is reflected in Equity income (loss) in the Consolidated Statements of Operations. We report our share of the income or loss of the equity method partner companies on a one quarter lag. We include the carrying value of equity method partner companies in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets. When the carrying value of our holdings in an equity method partner company is reduced to zero, no further losses are recorded in our Consolidated Statements of Operations unless we have outstanding guarantee obligations or have committed additional funding to the equity method partner company. When the equity method partner company subsequently reports income, we will not record our share of such income until it equals the amount of our share of losses not previously recognized.

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

#### Critical Accounting Policies and Estimates

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

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

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

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

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impairment to be recognized is measured as the amount by which the carrying value of an asset exceeds its fair value. The adjusted carrying value of a partner company is not increased if circumstances suggest the value of the partner company has subsequently recovered.

The fair value of privately held partner companies is generally determined based on the value at which independent third parties have invested or have committed to invest in these companies, or based on other valuation methods including discounted cash flows, valuations of comparable public companies and valuations of acquisitions of comparable companies. The fair value of our ownership interests in private equity funds is generally determined based on the fair value of our pro rata portion of the funds' net assets and estimated future proceeds from sales of investments provided by the funds' managers.

Our partner companies operate in industries which are rapidly evolving and extremely competitive. It is reasonably possible that our accounting estimates with respect to the ultimate recoverability of the carrying value of ownership interests in and advances to partner companies and funds could change in the near term and that the effect of such changes on our Consolidated Financial Statements could be material. While we believe that the current recorded carrying values of our equity and cost method companies are not impaired, there can be no assurance that our future results will confirm this assessment or that a significant write-down or write-off will not be required in the future.

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

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

Through our relationship with Penn Mezzanine, we have acquired participating interests in mezzanine loans and related equity interests in the borrowers. In certain instances, these interests also included warrants to purchase common stock of the borrowers. Our accounting policies for these participating interests are as follows:

##### Loan Participations Receivable

Our participating interests in Penn Mezzanine loans are included in Loan participations receivable on the Consolidated Balance Sheets. On a periodic basis, but no less frequently than at the end of each quarter, we evaluate the carrying value of each loan participation receivable for impairment. A loan participation receivable is considered impaired when it is probable that we will be unable to collect all amounts (principal and interest) due according to the contractual terms of the participation agreement and related agreements with the borrowers. We maintain an allowance to provide for estimated loan losses based on known and inherent risks in the loans. The allowance is provided based upon our analysis of the pertinent factors underlying the quality of the loans. These factors include an analysis of the financial condition of the borrowers, delinquency levels, actual loan loss experience, current economic conditions and other relevant factors. Our analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. We do not accrue interest when a loan is considered impaired. All cash receipts from impaired loans are applied to reduce the original principal amount of such loan, until the principal has been fully recovered and would be recognized as interest income thereafter.

##### Equity Participations

Our participations in equity interests acquired by Penn Mezzanine are accounted for under the cost method of accounting. On a periodic basis, but no less frequently than at the end of each quarter, we evaluate the carrying value of our participations in these equity interests for possible impairment based on achievement of business plan objectives and milestones, the fair value of the equity interests relative to their carrying value, the financial condition and prospects of the underlying company and other relevant factors. Our participating interests in equity interests acquired by Penn Mezzanine are included in Other assets on the Consolidated Balance Sheets.

##### Warrant Participations

We recognize our participations in warrants acquired by Penn Mezzanine based on the fair value of the warrants at the balance sheet date. The fair values of warrant participations are bifurcated from the related loan participation receivables based on the relative fair value of the respective instruments at the acquisition date. Any gain or loss associated with changes in the fair value of the warrants at the balance sheet date is recorded in Other income (loss),

net in the Consolidated Statements of Operations. The fair value of the warrants is included in Other assets on the Consolidated Balance Sheets.

Income Taxes

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

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

#### Commitments and Contingencies

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

#### Stock-Based Compensation

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

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

#### Results of Operations

The results of operations of all of our partner companies are reported in our Healthcare and Technology segments. The Healthcare and Technology segments also include the gain or loss on the sale of interests in our respective partner companies.

Our management evaluates the Healthcare and Technology segments' performance based on equity income (loss) which is based on 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, and Other income or loss associated with cost method partner companies.

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

Other items include certain expenses which are not identifiable to the operations of our operating business segments. Other items primarily consist of general and administrative expenses related to corporate operations, including

employee compensation, insurance and professional fees, interest income, interest expense, other income (loss) and equity income (loss) related to private equity holdings. Other items also include income taxes, which are reviewed by management independent of segment results.

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Healthcare	\$(4,742)	\$(11,325)	\$33,164	\$(33,665)
Technology	(4,109)	(3,490)	(6,108)	(7,990)
Penn Mezzanine	(92)	845	240	1,173
Total segments	(8,943)	(13,970)	27,296	(40,482)
Other items:				
Corporate operations	(5,063)	(5,460)	(17,331)	(19,010)
Income tax benefit (expense)	—	—	—	—
Total other items	(5,063)	(5,460)	(17,331)	(19,010)
Net income (loss)	\$(14,006)	\$(19,430)	\$9,965	\$(59,492)

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 listings of our Healthcare and Technology partner companies only include entities which were considered partner companies as of September 30, 2014. Certain entities which may have been partner companies in previous periods are omitted if, as of September 30, 2014, they had been sold or are no longer considered a partner company.

#### Healthcare

The following active partner companies as of September 30, 2014 were included in Healthcare:

Partner Company	Safeguard Primary Ownership as of September 30,		Accounting Method
	2014	2013	
AdvantEdge Healthcare Solutions, Inc.	40.1%	40.2%	Equity
Dabo Health, Inc.	12.9%	NA	Cost
Good Start Genetics, Inc.	29.9%	30.0%	Equity
InfoBionic Inc.	18.0%	NA	Equity (1)
Medivo, Inc.	34.5%	34.5%	Equity
NovaSom, Inc.	30.3%	30.3%	Equity
Propeller Health, Inc.	24.4%	NA	Equity
Putney, Inc.	28.3%	27.6%	Equity
Quantia, Inc.	42.3%	34.4%	Equity
Syapse, Inc.	27.0%	NA	Equity
Trice Medical, Inc.	31.9%	NA	Equity

(1) The decrease in our primary ownership below 20.0% in the third quarter of 2014 is considered temporary because we expect to deploy additional capital in InfoBionic in the fourth quarter of 2014. Accordingly, we continue to exercise significant influence over InfoBionic and account for it under the equity method.



Results of operations for the Healthcare segment were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Other income (loss), net	\$(8	) \$(4,772	) \$31,823	\$(6,362
Equity income (loss)	(4,734	) (6,553	) 1,341	(27,303
Net income (loss)	\$(4,742	) \$(11,325	) \$33,164	\$(33,665

Three months ended September 30, 2014 versus the three months ended September 30, 2013

Other Income (Loss), Net. Other loss, net decreased \$4.8 million for the three months ended September 30, 2014, compared to the prior year period. Other income (loss), net for the three months ended September 30, 2013 reflected an unrealized loss of \$4.8 million on the mark-to-market of our holdings in NuPathe.

Equity Income (Loss). Equity income (loss) fluctuates with the number of Healthcare partner companies accounted for under the equity method, our voting ownership percentage in these partner companies and the net results of operations of these partner companies. We recognize our share of losses to the extent we have cost basis in the partner company or outstanding commitments or guarantees. Certain amounts recorded to reflect our share of the income or losses of our partner companies accounted for under the equity method are based on estimates and on unaudited results of operations of those partner companies and may require adjustments in the future when audits of these entities are made final. We report our share of the results of our equity method partner companies on a one quarter lag basis. Equity loss for the Healthcare segment decreased \$1.8 million for the three months ended September 30, 2014 compared to the prior year period. Equity loss for the three months ended September 30, 2013 reflected an impairment charge of \$1.3 million related to PixelOptics, Inc., a former equity method partner company. The remaining decrease in equity loss for the three months ended September 30, 2014 compared to the prior year period was due to smaller losses incurred by partner companies included in the Healthcare segment.

Nine months ended September 30, 2014 versus the nine months ended September 30, 2013

Other Income (Loss), Net. Other income (loss), net increased \$38.2 million for the nine months ended September 30, 2014, compared to the prior year period. The increase was primarily due to the recognition of gains of \$27.4 million and \$3.0 million on the sales of former cost method partner company Crescendo Bioscience, Inc. and former fair value method partner company NuPathe, respectively, in February 2014. The increase also related to the recognition of a gain of \$1.5 million on the sale of former cost method partner company Sotera Wireless in April 2014. Other income (loss), net for the nine months ended September 30, 2013 reflected an unrealized loss of \$6.4 million on the mark-to-market of our holdings in NuPathe.

Equity Income (Loss). Equity income (loss) for the Healthcare segment increased \$28.6 million for the nine months ended September 30, 2014 compared to the prior year period. The increase was primarily due to the recognition of a gain of \$15.7 million on the sale of former equity method partner company Alverix, Inc. in January 2014. The increase in equity income (loss) was also due to smaller losses incurred by partner companies included in the Healthcare segment partially offset by a \$1.7 million adjustment related to the change in revenue recognition accounting at a partner company as discussed below. Equity income (loss) for the nine months ended September 30, 2013 also included an impairment charge of \$11.2 million related to PixelOptics, a former equity method partner company.

Our share of the earnings or losses of partner companies, as well as any adjustments resulting from prior period finalizations of equity income or loss, are reflected in Equity income (loss) on the Consolidated Statements of Operations. In the nine months ended September 30, 2014, the amount related to prior periods was \$1.8 million, of which \$0.3 million related to 2012 and \$1.5 million related to 2013. The adjustments are primarily related to a change in revenue recognition accounting at a partner company. We evaluated the quantitative and qualitative impact of the corrections on previously reported periods as well as on the nine months ended September 30, 2014. Based on this evaluation, we concluded that these adjustments were not material to our Consolidated Financial Statements.

## Technology

The following active partner companies as of September 30, 2014 were included in Technology:

Partner Company	Safeguard Primary Ownership as of		Accounting Method
	September 30,		
	2014	2013	
AppFirst, Inc.	34.3%	34.5%	Equity
Apprenda, Inc.	21.6%	NA	Equity
Beyond.com, Inc.	38.2%	38.2%	Equity
Bridgevine, Inc.	17.2%	22.7%	Cost (1)
Clutch Holdings, Inc.	29.6%	24.0%	Equity
DriveFactor, Inc.	40.6%	40.6%	Equity
Hoopla Software, Inc.	25.6%	25.3%	Equity
Lumesis, Inc.	48.5%	44.2%	Equity
MediaMath, Inc.	20.5%	22.5%	Equity
Pneuron Corporation	27.6%	27.6%	Equity
Spongecell, Inc.	23.0%	23.0%	Equity
Transactis, Inc.	24.8%	NA	Equity
WebLinc, Inc.	29.2%	NA	Equity

(1) In the second quarter of 2014, our ownership interest in Bridgevine decreased from 22.7% to 17.3%, below the threshold at which we believe we exercise significant influence. Accordingly, we changed our method of accounting for Bridgevine from the equity method to the cost method at such time.

Results of operations for the Technology segment were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Equity loss	\$(4,109)	\$(3,490)	\$(6,108)	\$(7,990)
Net loss	\$(4,109)	\$(3,490)	\$(6,108)	\$(7,990)

Three months ended September 30, 2014 versus the three months ended September 30, 2013

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

Equity loss for the Technology segment increased \$0.6 million for the three months ended September 30, 2014, compared to the prior year period. The increase was related to an increase in losses incurred by partner companies included in the Technology segment.

Nine months ended September 30, 2014 versus the nine months ended September 30, 2013

Equity Loss. Equity loss for the Technology segment decreased \$1.9 million for the nine months ended September 30, 2014, compared to the prior year period. The decrease was primarily related to a \$7.0 million unrealized gain on the decrease of our percentage ownership interest in MediaMath, partially offset by a \$0.3 million unrealized loss on the decrease of our percentage ownership interest in Bridgevine and an increase in losses incurred by partner companies included in the Technology segment.

## Penn Mezzanine

Results for the Penn Mezzanine segment were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
General and administrative expense	\$ (3)	) \$ (4)	) \$ (8)	) \$ (13)
Other income (loss), net	(238)	) 547	(243)	) 324
Interest income	307	394	1,087	1,118
Equity loss	(158)	) (92)	) (596)	) (256)
Net income (loss)	\$ (92)	) \$ 845	\$ 240	\$ 1,173

Results of the Penn Mezzanine segment include interest, dividends, loan origination and other fees earned on the mezzanine interests in which we participate, gain (loss) on the mark-to-market of our warrant participations, any impairment on our debt and equity participation interests as well as equity income (loss) associated with our interest in the management company and general partner of Penn Mezzanine. As of September 30, 2014, we had participating interests in four loans and five equity investments initiated by Penn Mezzanine. We have determined that we will not be making any further new capital deployments in connection with Penn Mezzanine lending activities. We will continue to collect principal and interest payments from our existing participating interests in Penn Mezzanine loans. Three months ended September 30, 2014 versus the three months ended September 30, 2013

**Other Income (Loss), Net.** Other income (loss), net for Penn Mezzanine decreased \$0.8 million for the three months ended September 30, 2014 compared to the prior year period. During the three months ended September 30, 2014, we recorded a loss on the sale of one of our Penn Mezzanine equity interests of \$0.3 million. During the three months ended September 30, 2013, we recorded a gain on the sale of one of our Penn Mezzanine equity interests of \$0.5 million.

**Equity Loss.** Equity loss increased \$0.1 million for the three months ended September 30, 2014, compared to the prior year period. The increase in equity loss related to an increase in legal expenses incurred at the management company of Penn Mezzanine.

General and administrative expense and interest income remained consistent for the three months ended September 30, 2014, compared to the prior year period. We anticipate interest income will decrease in future periods as participating interests in existing mezzanine loans are repaid.

Nine months ended September 30, 2014 versus the nine months ended September 30, 2013

**Other Income (Loss), Net.** Other income (loss), net for Penn Mezzanine decreased \$0.6 million for the nine months ended September 30, 2014 compared to the prior year period. During the nine months ended September 30, 2014, we recorded a loss on the sale of one of our Penn Mezzanine equity interests of \$0.3 million. During the nine months ended September 30, 2013, we recorded a gain on the sale of one of our Penn Mezzanine equity interests of \$0.5 million which was partially offset by an impairment charge associated with our equity and loan participations of \$0.3 million.

**Equity Loss.** Equity loss increased \$0.3 million for the nine months ended September 30, 2014, compared to the prior year period. The increase in equity loss related to an increase in legal expenses incurred at the management company of Penn Mezzanine.

General and administrative expense and interest income remained consistent for the nine months ended September 30, 2014, compared to the prior year period. We anticipate interest income will decrease in future periods as participating interests in existing mezzanine loans are repaid.

## Corporate Operations

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
General and administrative expense	\$(3,983	) \$(4,301	) \$(12,839	) \$(15,033
Stock-based compensation	(176	) (510	) (1,583	) (1,808
Depreciation	(15	) (20	) (55	) (70
Other income (loss), net	—	1	—	(153
Interest income	175	178	407	978
Interest expense	(1,103	) (1,077	) (3,295	) (3,220
Equity income (loss)	39	269	34	296
	\$(5,063	) \$(5,460	) \$(17,331	) \$(19,010

Three months ended September 30, 2014 versus the three months ended September 30, 2013

**General and Administrative Expense.** Our general and administrative expenses consist primarily of employee compensation, insurance, travel-related costs, office rent and professional services such as consulting, legal, and accounting. General and administrative expense decreased \$0.3 million for the three months ended September 30, 2014 compared to the prior year period primarily due to a decrease of \$0.4 million in costs associated with a transitional services agreement with our previous Chief Executive Officer which was partially offset by a \$0.1 million increase in employee costs.

**Stock-Based Compensation.** Stock-based compensation consists primarily of expense related to stock option grants and grants of restricted stock and deferred stock units to our employees and directors. Stock-based compensation decreased \$0.3 million when compared to the prior year period primarily due to a decrease in expense associated with deferred stock units and restricted stock awards.

**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. Interest income remained relatively consistent compared to the prior year period.

**Interest Expense.** Interest expense is primarily related to our convertible senior debentures. Interest expense remained relatively consistent compared to the prior year period.

**Equity Income (Loss).** Equity income (loss) for both periods relates to our private equity holdings accounted for under the equity method. The decrease of \$0.2 million for the three months ended September 30, 2014 compared to the prior year period was primarily attributable to a decrease of \$0.2 million in distributions from our private equity holdings.

Nine months ended September 30, 2014 versus the nine months ended September 30, 2013

**General and Administrative Expense.** General and administrative expense decreased \$2.2 million for the nine months ended September 30, 2014 compared to the prior year period primarily due to a decrease of \$1.2 million in costs associated with a transitional services agreement with our previous Chief Executive Officer, a decrease in severance expense of \$0.9 million related to a former executive and a decrease of \$0.7 million in professional fees. These decreases were partially offset by a \$0.7 million increase in employee costs.

**Stock-Based Compensation.** Stock-based compensation decreased \$0.2 million when compared to the prior year period primarily due to an decrease in expense associated with deferred stock units and restricted stock awards.

**Other Income (Loss), Net.** Other income (loss), net for the nine months ended September 30, 2013 reflected an impairment charge of \$0.2 million related to our interest in a legacy private equity fund.

**Interest Income.** The decrease in interest income of \$0.6 million for the nine months ended September 30, 2014 compared to the prior year period was primarily attributable to lower average notes receivable from our partner companies.

**Interest Expense.** Interest expense remained relatively consistent compared to the prior year period.

**Equity Income (Loss).** The decrease of \$0.3 million for the nine months ended September 30, 2014 compared to the prior year period was primarily attributable to a decrease of \$0.2 million in distributions from our private equity holdings.



#### Income Tax Expense (Benefit)

Income tax expense (benefit) for the three and nine months ended September 30, 2014 and 2013 was \$0. We have recorded a valuation allowance to reduce our net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the tax expense that would have been recognized for the nine months ended September 30, 2014 was offset by changes in the valuation allowance. The benefit of the net operating loss that would have been recognized for the three months ended September 30, 2014 and 2013 and the nine months ended September 30, 2013 was also offset by changes in the valuation allowance.

#### Liquidity and Capital Resources

We fund our operations with cash on hand as well as proceeds from sales of and distributions from partner companies, private equity funds and marketable securities. In prior periods, we have also used sales of our equity and the issuance of debt as sources of liquidity and may do so in the future. 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.

As of September 30, 2014, we had \$116.7 million of cash and cash equivalents and \$49.1 million of marketable securities for a total of \$165.8 million.

In April 2014, we sold our ownership interest in Sotera Wireless for approximately \$4.2 million in cash proceeds.

In February 2014, Crescendo Bioscience was acquired by Myriad Genetics, Inc. We received \$38.4 million in cash proceeds in connection with the transaction, excluding \$2.9 million, net of claims paid through September 30, 2014, which will be held in escrow until approximately May 2015.

In February 2014, NuPathe was acquired by Teva Pharmaceutical Industries Ltd. for \$3.65 per share in cash. In addition to the upfront cash payment, NuPathe shareholders received rights to receive additional cash payments of up to \$3.15 per share if specified milestones are achieved over time. We received initial net cash proceeds of \$23.1 million as a result of the transaction. Depending on the achievement of the milestones, we may receive up to an additional \$24.2 million.

In January 2014, Alverix was acquired by Becton, Dickinson and Company. We received cash proceeds of \$15.7 million, excluding \$1.7 million which will be held in escrow until approximately July 2015.

For the nine months ended September 30, 2014, we received cash proceeds of \$4.3 million from the repayment of loan participations receivable and \$1.3 million from the sale of an equity interest initiated by Penn Mezzanine.

In December 2013, ThingWorx, Inc. was acquired by PTC Inc. We received cash proceeds of \$36.4 million, excluding \$4.1 million which will be held in escrow until December 2015. Depending on the achievement of certain milestones, we may receive up to an additional \$6.5 million in connection with the transaction.

In June 2011, Advanced BioHealing, Inc. was acquired by Shire plc. Prior to the expiration of the escrow period in March 2012, Shire plc filed a claim against \$7.6 million held in escrow related to the sale. No further proceeds will be distributed to us or other former owners until the validity of such claims is determined. We presently view it as unlikely that we will receive any portion of such amount in the short or long-term.

Depending on the achievement of certain difficult commercial and regulatory milestones, we could receive additional proceeds of up to \$54.0 million by the end of 2018 related to the December 2010 sale of our former partner company Avid Radiopharmaceuticals, Inc. We presently view it as unlikely that we will receive any significant portion of such amount in the short or long-term.

We have outstanding \$55.0 million in face amount of our 5.25% convertible senior debentures due 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, 2014 was \$18.40. The 2018 Debentures holders have the right to require us to repurchase the 2018 Debentures if we undergo a fundamental change as defined in the debenture agreement, including the sale of all or substantially all of our common stock or assets, liquidation, or dissolution; a change in control, the delisting of our common stock from the New York Stock Exchange or the NASDAQ Global Market (or any of their respective successors); or a substantial change in the



composition of our board of directors as defined in the agreement. On or after November 15, 2016, we may redeem for cash some or all of the debentures, subject to certain conditions. Upon any redemption of the 2018 Debentures,

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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 February 2014, our Board of Directors authorized us, from time to time and depending on market conditions, to repurchase up to \$25.0 million of our outstanding common stock. During the nine months ended September 30, 2014, we repurchased 1.2 million shares at an aggregate cost of \$25.0 million. This share repurchase program was completed in May 2014.

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

At September 30, 2014, we had committed capital of approximately \$0.2 million to private equity funds. These commitments are expected to be funded in the next 12 months.

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

Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner of a private equity fund for further distribution to such fund's limited partners ("clawback"). The maximum clawback we could be required to return related to our general partner interest is \$1.3 million, of which \$1.0 million was reflected in Accrued expenses and other current liabilities and \$0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheets at September 30, 2014. Our ownership in the fund is 19%. The clawback liability is joint and several, such that we may be required to fund the clawback for other general partners should they default. We believe our potential liability due to the possibility of default by other general partners is remote.

For the reasons we have presented above, we believe our cash and cash equivalents at September 30, 2014, availability under our revolving credit facility and other internal sources of cash flow will be sufficient to fund our cash requirements for at least the next 12 months, including interest payments, commitments to our existing partner companies and funds, possible additional funding of existing partner companies and our general corporate requirements. Our acquisition of new partner company interests is always contingent upon our availability of cash to fund such deployments, and our timing of monetization events directly affects our availability of cash.

#### Analysis of Consolidated Cash Flows

Cash flow activity was as follows:

	Nine months ended September 30,	
	2014	2013
	(In thousands)	
Net cash used in operating activities	\$(15,475	) \$(16,299
Net cash provided by investing activities	17,706	54,610
Net cash provided by (used in) financing activities	(24,865	) 4,354
	\$(22,634	) \$42,665
<b>Net Cash Used In Operating Activities</b>		

Net cash used in operating activities decreased by \$0.8 million for the nine months ended September 30, 2014 compared to the prior year period. The decrease was primarily related to a decrease in cash used for professional fees of \$1.4 million and a decrease in cash severance payments of \$0.9 million. These decreases were partially offset by an increase of \$1.1 million related to final payments associated with a transitional services agreement with our previous Chief Executive Officer and an increase of \$0.4 million in cash used for management incentive plan payments.

### Net Cash Provided by Investing Activities

Net cash provided by investing activities decreased by \$36.9 million for the nine months ended September 30, 2014 compared to the prior year period. The decrease primarily related to a \$87.2 million decrease in cash proceeds from the net change in marketable securities, a \$26.2 million increase in acquisitions of ownership interests in companies and funds and a decrease in proceeds from the sale of discontinued operations of \$6.4 million which related to the release of escrow funds in June 2013. These decreases were partially offset by a \$79.0 million increase in proceeds from the sales of and distributions from companies and funds, primarily related to the 2014 sales of our interests in Crescendo Bioscience, Alverix, NuPathe and Sotera Wireless, and an increase of \$4.5 million in repayments of advances and loans to companies.

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

Net cash used in financing activities increased by \$29.2 million for the nine months ended September 30, 2014 compared to the prior year period. The increase primarily related to \$25.0 million in repurchases of our common stock, the repurchase of \$0.4 million of our 2024 Debentures and a \$3.8 million decrease in the proceeds received from the exercise of stock options.

### Contractual Cash Obligations and Other Commercial Commitments

The following table summarizes our contractual obligations and other commercial commitments as of September 30, 2014 by period due or expiration of the commitment.

	Payments Due by Period				
	Total	Remainder of 2014	2015 and 2016	2017 and 2018	Due after 2018
Contractual Cash Obligations:	(In millions)				
Convertible senior debentures (a)	\$55.0	\$ —	\$—	\$55.0	\$—
Interest payments on long-term debt	11.5	1.4	5.8	4.3	—
Operating leases	0.5	0.1	0.4	—	—
Funding commitments (b)	0.2	0.1	0.1	—	—
Potential clawback liabilities (c)	1.3	1.0	—	0.3	—
Other long-term obligations (d)	3.3	0.8	1.6	0.9	—
Total Contractual Cash Obligations	\$71.8	\$ 3.4	\$7.9	\$60.5	\$—

### Amount of Commitment Expiration by Period

	Amount of Commitment Expiration by Period				
	Total	Remainder of 2014	2015 and 2016	2017 and 2018	Due after 2018
Other Commitments:	(In millions)				
Letters of credit (e)	\$6.3	\$ —	\$—	\$—	\$6.3

(a) We have outstanding \$55.0 million of our 5.25% convertible senior debentures due May 15, 2018.

(b) This represents funding commitments to private equity funds based on estimated timing of capital calls provided to us by the funds' management.

Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner of a private equity fund for a further distribution to such fund's limited partners ("clawback"). The maximum clawback we could be required to return is approximately \$1.3 million, of which \$1.0 million was reflected in Accrued expenses and other current liabilities and \$0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet as of September 30, 2014.

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

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

We have agreements with certain employees that provide for severance payments to the employee in the event the employee is terminated without cause or if the employee terminates his employment for "good reason." The maximum aggregate cash exposure under the agreements was approximately \$3.0 million at September 30, 2014.

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

#### Factors That May Affect Future Results

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

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

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

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

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

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

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

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

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

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

Our business model does not rely upon, or plan for, the receipt of operating cash flows from our partner companies.

Our partner companies generally provide us with no cash flow from their operations. We rely on cash on hand, liquidity events and our ability to generate cash from capital raising activities to finance our operations.

We need capital to develop new partner company relationships and to fund the capital needs of our existing partner companies. We also need cash to service and repay our outstanding debt, finance our corporate overhead and meet our existing funding commitments. As a result, we have substantial cash requirements. Our partner companies generally provide us with no cash flow from their operations. To the extent our partner companies generate any cash from

operations, they generally retain the funds to develop their own businesses. As a result, we must rely on cash on hand, partner company liquidity events and new capital raising activities to meet our cash needs. If we are unable to find ways of monetizing our holdings or raising additional

capital on attractive terms, we may face liquidity issues that will require us to curtail our new business efforts, constrain our ability to execute our business strategy and limit our ability to provide financial support to our existing partner companies.

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

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

Intense competition from other 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 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 controlling ownership interest. The actions we may need to take to address these issues while maintaining compliance with the 40% Test could adversely affect our ability to create and realize value at our partner companies.

Economic disruptions and downturns may have negative repercussions for us.

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

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

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

#### Risks Related to Our Partner Companies

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

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

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There is intense competition in the technology and healthcare marketplaces, and we expect competition to intensify in the future. Our business, financial condition, results of operations and prospects for growth will be materially adversely affected if our partner companies are not able to compete successfully. Many of the present and potential competitors may have greater financial, technical, marketing and other resources than those of our partner companies. This may place our partner companies at a disadvantage in responding to the offerings of their competitors, technological changes or changes in client requirements. Also, our partner companies may be at a competitive disadvantage because many of their competitors have greater name recognition, more extensive client bases and a broader range of product offerings. In addition, our partner companies may compete against one another. The success or failure of many of our partner companies is dependent upon the ultimate effectiveness of newly-created information technologies, medical devices, healthcare diagnostics, etc. Our partner companies' business strategies are often highly dependent upon the successful launch and commercialization of an innovative information technology, medical device, healthcare diagnostic, or similar device or technology. Despite all of our efforts to understand the research and development underlying the innovation or creation of such technologies before we deploy capital into a partner company, sometimes the performance of the technology or device does not match our expectations or those of our partner company. In those situations, it is likely that we will incur a partial or total loss of the capital which we deployed in such partner company. Our partner companies may fail if they do not adapt to changing marketplaces. If our partner companies fail to adapt to changes in technology and customer and supplier demands, they may not become or remain profitable. There is no assurance that the products and services of our partner companies will achieve or maintain market penetration or commercial success, or that the businesses of our partner companies will be successful.

The healthcare and technology marketplaces are characterized by:

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

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

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

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

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

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

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

available from third parties on acceptable terms, if at all.

We cannot be certain that our partner companies will be able to obtain additional financing on favorable terms when needed, if at all. Because our resources and our ability to raise capital are not unlimited, we may not be able to provide partner

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

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

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

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

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

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

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

Because manufacture and sale of certain partner company products entail an inherent risk of product liability, certain partner companies maintain product liability insurance. Although none of our current partner companies have experienced any material losses in this regard, there can be no assurance that they will be able to maintain or acquire adequate product liability insurance in the future and any product liability claim could have a material adverse effect

on a partner company's financial stability, revenues and results of operations. In addition, many of the engagements of our partner companies involve projects that are critical to the operation of their clients' businesses. If our partner companies fail to meet their contractual obligations, they could be subject to legal liability, which could adversely affect their business, operating results and financial condition. Partner company contracts typically include provisions designed to limit their exposure to legal claims relating to their services and products. However, these provisions may not protect our partner companies or may not be enforceable. Also, some of our partner companies depend on their relationships with their clients and their reputation for high-quality services and integrity to retain and attract clients. As a result, claims made against our partner companies' work may damage their reputation, which in turn could impact their ability to compete for new work and negatively impact their revenue and profitability.

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

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

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

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



#### Risks Related to Initiatives Outside Our Core Business

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

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

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

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

#### Subordination

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

#### Debt securities

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

#### Leverage

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

factors (or other factors) such as downturns in the economy or deterioration in the condition of the borrower or its industry. Because these

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

#### Minority positions

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

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

At September 30, 2014, we had \$55.0 million outstanding of our 5.25% convertible senior debentures due May 15, 2018.

Liabilities	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total	Fair Value at September 30, 2014
2018 Debentures due by year (in millions)	\$ —	\$ —	\$ —	\$ —	\$55.0	\$ —	\$55.0	\$68.5
Fixed interest rate	5.25 %	5.25 %	5.25 %	5.25 %	5.25 %		5.25 %	

#### 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, 2014 are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

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

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

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

There have been no material changes in our risk factors from the information set forth above under the heading “Factors That May Affect Future Results” and in our Annual Report on Form 10-K for the year ended December 31, 2013.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

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## Item 6. Exhibits

## (a) Exhibits.

The following is a list of exhibits required by Item 601 of Regulation S-K to be filed as part of this Report. For exhibits that previously have been filed, the Registrant incorporates those exhibits herein by reference. 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 †	Certification of Stephen T. Zarrilli pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934.
31.2 †	Certification of Jeffrey B. McGroarty pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934.
32.1 ‡	Certification of Stephen T. Zarrilli pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 ‡	Certification of Jeffrey B. McGroarty pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from Safeguard Scientifics, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets (unaudited) – September 30, 2014 and December 31, 2013; (ii) Consolidated Statements of Operations (unaudited) – Three and nine months ended September 30, 2014 and 2013; (iii) Consolidated Statements of Comprehensive Income (Loss) (unaudited) – Three and nine months ended September 30, 2014 and 2013; (iv) Condensed Consolidated Statements of Cash Flows (unaudited) – Nine months ended September 30, 2014 and 2013; (v) Consolidated Statement of Changes in Equity (unaudited) – Nine months ended September 30, 2014; 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.

Date: October 24, 2014

SAFEGUARD SCIENTIFICS, INC.

/s/ Stephen T. Zarrilli

Stephen T. Zarrilli

President and Chief Executive Officer

Date: October 24, 2014

/s/ Jeffrey B. McGroarty

Jeffrey B. McGroarty

Senior Vice President and Chief Financial  
Officer