

SAFEGUARD SCIENTIFICS INC

Form 10-Q

July 27, 2012

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# SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

## FORM 10-Q

### Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarter Ended June 30, 2012

Commission File Number 1-5620

## Safeguard Scientifics, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania  
(State or other jurisdiction of

incorporation or organization)

23-1609753  
(I.R.S. Employer

ID No.)

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435 Devon Park Drive

Building 800

Wayne, PA

(Address of principal executive offices)

19087

(Zip Code)

(610) 293-0600

Registrant's telephone number, including area code

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes  No

Number of shares outstanding as of July 26, 2012

Common Stock 20,808,745

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**SAFEGUARD SCIENTIFICS, INC.**  
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	June 30, 2012	December 31, 2011
	(In thousands except per share data)	
	(Unaudited)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 58,725	\$ 83,187
Cash held in escrow	6,433	6,433
Marketable securities	143,485	158,098
Restricted cash equivalents	5,232	5,137
Prepaid expenses and other current assets	1,418	1,081
Total current assets	215,293	253,936
Property and equipment, net	193	228
Ownership interests in and advances to partner companies and funds	113,411	114,169
Loan participations receivable	7,400	7,587
Available-for-sale securities	11,027	5,184
Long-term marketable securities	39,146	16,287
Long-term restricted cash equivalents	4,752	7,128
Other	1,664	2,117
Total Assets	\$ 392,886	\$ 406,636
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 226	\$ 243
Accrued compensation and benefits	2,636	4,583
Accrued expenses and other current liabilities	3,765	3,690
Total current liabilities	6,627	8,516
Other long-term liabilities	4,012	4,146
Convertible senior debentures - non-current	46,036	45,694
Commitments and contingencies		
Equity:		
Preferred stock, \$0.10 par value; 1,000 shares authorized		
Common stock, \$0.10 par value; 83,333 shares authorized; 20,797 and 20,752 shares issued and outstanding in 2012 and 2011, respectively	2,080	2,075
Additional paid-in capital	812,735	810,956
Accumulated deficit	(484,507)	(464,710)
Accumulated other comprehensive income (loss)	5,903	(41)
Total equity	336,211	348,280
Total Liabilities and Equity	\$ 392,886	\$ 406,636

See Notes to Consolidated Financial Statements.



**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands except per share data)			
	(Unaudited)			
General and administrative expense	\$ 5,148	\$ 5,570	\$ 9,891	\$ 10,454
Operating loss	(5,148)	(5,570)	(9,891)	(10,454)
Other income (loss), net	4,819	(775)	7,903	(1,067)
Interest income	595	324	1,494	691
Interest expense	(1,456)	(1,441)	(2,908)	(3,077)
Equity income (loss)	(8,947)	129,277	(16,395)	126,712
Net income (loss) before income taxes	(10,137)	121,815	(19,797)	112,805
Income tax benefit (expense)				
Net income (loss)	\$ (10,137)	\$ 121,815	\$ (19,797)	\$ 112,805
Net income (loss) per share:				
Basic	\$ (0.48)	\$ 5.87	\$ (0.95)	\$ 5.45
Diluted	\$ (0.48)	\$ 5.05	\$ (0.95)	\$ 4.69
Average shares used in computing income (loss) per share:				
Basic	20,927	20,741	20,903	20,709
Diluted	20,927	24,374	20,903	24,660

See Notes to Consolidated Financial Statements.

**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	<b>Three Months Ended June 30, 2012</b>	<b>2011</b>	<b>Six Months Ended June 30, 2012</b>	<b>2011</b>
	<b>(In thousands)</b>			
	<b>(Unaudited)</b>			
Net income (loss)	\$ (10,137)	\$ 121,815	\$ (19,797)	\$ 112,805
Other comprehensive income (loss), before taxes:				
Unrealized net income (loss) on available-for-sale securities	734	(1,939)	5,800	(5,235)
Reclassification adjustment for other than temporary impairment of available-for-sale securities included in net income (loss)	144	795	144	1,131
<b>Total comprehensive income (loss)</b>	<b>\$ (9,259)</b>	<b>\$ 120,671</b>	<b>\$ (13,853)</b>	<b>\$ 108,701</b>

See Notes to Consolidated Financial Statements.

**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
	<b>(Unaudited)</b>	
<b>Cash Flows from Operating Activities:</b>		
Net cash used in operating activities	\$ (9,624)	\$ (10,392)
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sales of and distributions from companies and funds	11,061	137,991
Advances and loans to companies	(5,141)	(750)
Origination fees on mezzanine loans	46	
Acquisitions of ownership interests in companies and funds	(16,190)	(59,108)
Increase in marketable securities	(141,997)	(70,389)
Decrease in marketable securities	133,751	53,067
Proceeds from sale of discontinued operations, net		1
Repayment of advances to companies	3,144	
Capital expenditures	(25)	(7)
Other, net		107
Net cash provided by (used in) investing activities	(15,351)	60,912
<b>Cash Flows from Financing Activities:</b>		
Repurchase of convertible senior debentures		(30,848)
Issuance of Company common stock, net	513	346
Net cash provided by (used in) financing activities	513	(30,502)
Net Increase (Decrease) in Cash and Cash Equivalents	(24,462)	20,018
Cash and Cash Equivalents at beginning of period	83,187	183,419
Cash and Cash Equivalents at end of period	\$ 58,725	\$ 203,437

See Notes to Consolidated Financial Statements.



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## SAFEGUARD SCIENTIFICS, INC.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Total	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss) (In thousands) (Unaudited)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital
<b>Balance December 31, 2011</b>	\$ 348,280	\$ (464,710)	\$ (41)	20,752	\$ 2,075	\$ 810,956
Net loss	(19,797)	(19,797)				
Stock options exercised, net	514			40	5	509
Issuance of restricted stock, net	41			5		41
Stock-based compensation expense	1,229					1,229
Other comprehensive income	5,944		5,944			
<b>Balance June 30, 2012</b>	\$ 336,211	\$ (484,507)	\$ 5,903	20,797	\$ 2,080	\$ 812,735

See Notes to Consolidated Financial Statements.

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**SAFEGUARD SCIENTIFICS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. General**

The accompanying unaudited interim Consolidated Financial Statements of Safeguard Scientifics, Inc. (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 footnote 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 2011 Annual Report on Form 10-K.

**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****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.

	June 30, 2012	December 31, 2011
	(In thousands)	
	(Unaudited)	
<b>Equity Method:</b>		
Partner companies	\$ 103,132	\$ 104,545
Private equity funds	5,565	5,784
	108,697	110,329
<b>Cost Method:</b>		
Private equity funds	2,634	2,984
	2,634	2,984
Advances to partner companies	2,080	856
	\$ 113,411	\$ 114,169
Loan participations receivable	\$ 7,400	\$ 7,587
Available-for-sale securities	\$ 11,027	\$ 5,184

The Company recognized an impairment charge of \$3.7 million related to PixelOptics Inc. ( PixelOptics ) in the three months ended June 30, 2012 which is reflected in Equity income (loss) in the Consolidated Statement of Operations. The impairment was based upon launch delays and related supply chain issues that PixelOptics is addressing, as well as the pricing of a transaction between other institutional shareholders in PixelOptics.

The Company recorded an impairment charge of \$0.7 million related to its Penn Mezzanine debt and equity participations in the three months ended June 30, 2012 which is reflected in Other income (loss), net in the Consolidated Statement of Operations. The charge included \$0.2 million related to loan participations, \$0.4 million related to equity 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 \$0.4 million related to its interest in a legacy private equity fund, in the first quarter of 2012 which is reflected in Other income (loss), net in the Consolidated Statement of Operations.

The Company accounts for its holdings in NuPathe, Inc. ( NuPathe ) and Tengion, Inc. ( Tengion ) as available-for-sale securities. The Company recognized an impairment charge of \$0.1 million in the second quarter of 2012 which is reflected in Other income (loss), net, in the Consolidated Statements of Operations, representing the unrealized loss on the mark-to-market of its ownership interest in Tengion, which was previously recorded as a separate component of equity. The Company determined that the decline in the value of its public holdings in Tengion was other than temporary. For the three and six months ended June 30, 2012 the Company's holdings of available-for-sale securities in NuPathe had generated an unrealized gain of \$0.9 million and \$5.9 million, respectively. As of June 30, 2012, the Company's adjusted cost basis in NuPathe and Tengion securities was \$4.9 million and \$0.2 million, respectively.



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The following unaudited summarized results of operations for the three months ended March 31, 2012 for PixelOptics have been compiled from the unaudited financial statements of PixelOptics. The results of PixelOptics are reported on a one quarter lag.

	<b>Three Months Ended March 31, 2012 (In thousands) (Unaudited)</b>
<b>Results of Operations:</b>	
Revenue	\$ 307
Operating loss	\$ (8,721)
Net loss	\$ (9,012)

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**SAFEGUARD SCIENTIFICS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

In April 2012, the Company funded \$2.1 million of a convertible bridge loan to PixelOptics. The Company funded an additional \$2.0 million of this convertible bridge loan in July 2012. The Company previously deployed \$25.0 million in PixelOptics in April 2011. PixelOptics provides electronic corrective eyeglasses designed to substantially reduce or eliminate the visual distortion and other limitations associated with multifocal lenses. The Company accounts for its interest in PixelOptics under the equity method. The difference between the Company's cost and its interest in the underlying net assets of PixelOptics was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In March 2012, the Company deployed an additional \$3.7 million in Good Start Genetics, Inc. ( Good Start ). The Company had previously acquired an interest in Good Start in 2010 for \$6.8 million. Good Start has developed a pre-pregnancy genetic test, which utilizes an advanced DNA sequencing technology to screen for a panel of genetic disorders, including those recommended by the American Congress of Obstetricians and Gynecologists and the American College of Medical Genetics. The Company accounts for its interest in Good Start under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Good Start was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In February 2012, the Company acquired a 23.1% ownership interest in Spongecell, Inc. ( Spongecell ) for \$10.0 million. Spongecell is a digital advertising technology company that enhances standard banner ads with rich interactive features. The Company accounts for its ownership interest in Spongecell under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Spongecell was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In February 2012, the Company acquired a 31.6% ownership interest in Lumesis, Inc. ( Lumesis ) for \$2.2 million. Lumesis is a financial technology company that is dedicated to delivering timely data and robust analytical tools for the fixed income marketplace. The Company accounts for its interest in Lumesis under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Lumesis was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In February 2012, the Company funded \$0.8 million of a convertible bridge loan to Alverix, Inc. ( Alverix ). The Company previously deployed an aggregate of \$7.6 million in Alverix. Alverix provides next-generation instrument and connectivity platforms for diagnostic Point-of-Care (POC) testing. The Company accounts for its interest in Alverix under the equity method.

In January 2012, the Company funded \$2.5 million for participations in loan and equity interests initiated by Penn Mezzanine. Included in this funding was \$2.3 million for participation in a loan and \$0.2 million for participation in equity of the borrower acquired by Penn Mezzanine. The loan principal was repaid in March 2012.

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**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 into three broad levels. 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.

**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table provides the assets and liabilities measured at fair value on a recurring basis as of June 30, 2012 and December 31, 2011:

	Carrying Value	Fair Value Measurement at June 30, 2012		
		Level 1	Level 2	Level 3
		(In thousands) (Unaudited)		
Cash and cash equivalents	\$ 58,725	\$ 58,725	\$	\$
Cash held in escrow	\$ 6,433	\$ 6,433	\$	\$
Restricted cash equivalents	\$ 9,984	\$ 9,984	\$	\$
Available-for-sale securities	\$ 11,027	\$ 11,027	\$	\$
Warrant participations	\$ 201	\$	\$	\$ 201
Marketable securities - held-to-maturity:				
Commercial paper	\$ 65,693	\$ 65,693	\$	\$
U.S. Treasury Bills	15,651	15,651		
Government agency bonds	67,506	67,506		
Corporate bonds	281	281		
Certificates of deposit	33,500	33,500		
	\$ 182,631	\$ 182,631	\$	\$

	Carrying Value	Fair Value Measurement at December 31, 2011		
		Level 1	Level 2	Level 3
		(In thousands) (Unaudited)		
Cash and cash equivalents	\$ 83,187	\$ 83,187	\$	\$
Cash held in escrow	\$ 6,433	\$ 6,433	\$	\$
Restricted cash equivalents	\$ 12,265	\$ 12,265	\$	\$
Available-for-sale securities	\$ 5,184	\$ 5,184	\$	\$
Warrant participations	\$ 276	\$	\$	\$ 276
Marketable securities - held-to-maturity:				
Commercial paper	\$ 42,919	\$ 42,919	\$	\$
U.S. Treasury Bills	17,555	17,555		
Government agency bonds	80,712	80,712		
Corporate bonds	1,296	1,296		
Certificates of deposit	31,903	31,903		
	\$ 174,385	\$ 174,385	\$	\$



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**SAFEGUARD SCIENTIFICS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of June 30, 2012, \$143.5 million of marketable securities had contractual maturities which were less than one year and \$39.1 million of marketable securities had contractual maturities greater than one year. Held-to-maturity securities are carried at amortized cost, which, due to the short-term maturity of these instruments, approximates fair value using quoted prices in active markets for identical assets or liabilities defined as Level 1 inputs under the fair value hierarchy.

The Company recorded an impairment charge of \$3.7 million related to PixelOptics in the three months ended June 30, 2012 measured as the amount by which PixelOptics' carrying value exceeded its estimated fair value. The fair market value of the Company's equity ownership in PixelOptics was determined to be \$11.4 million based on Level 3 inputs as defined above. The inputs and valuation techniques used included discounted cash flows as well as the pricing of a transaction between other institutional shareholders in PixelOptics debt and equity securities.

The Company recorded an impairment charge of \$0.7 million related to its Penn Mezzanine debt and equity participations in the three months ended June 30, 2012 measured as the amount by which the carrying value of the Company's participation in the debt and equity interests acquired by Penn Mezzanine exceeded their estimated fair values. The fair market values of the Company's participating interests in debt, equity and warrants acquired by Penn Mezzanine were determined based on Level 3 inputs as defined above. The inputs and valuation techniques used included discounted cash flows and valuations of comparable public companies.

The Company recognized an impairment charge of \$0.4 million related to a legacy private equity fund in the first quarter of 2012, 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 \$1.9 million based on the value of the Company's pro rata portion of the fair value of the fund's net assets, which is a Level 3 input under the fair value hierarchy.

The Company accounts for its holdings in NuPathe and Tengion as available-for-sale securities. The value of the Company's available-for-sale securities is measured by reference to quoted prices for NuPathe and Tengion's common stock as traded on the NASDAQ Capital Market, which is considered a Level 1 input under the valuation hierarchy.

**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Convertible Debentures and Credit Arrangements**

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

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
		<b>(In thousands)</b>
		<b>(Unaudited)</b>
Convertible senior debentures due 2024	\$ 441	\$ 441
Convertible senior debentures due 2014	45,595	45,253
	<b>\$ 46,036</b>	<b>\$ 45,694</b>

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**SAFEGUARD SCIENTIFICS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Convertible Senior Debentures due 2024***

In 2004, the Company issued an aggregate of \$150 million in face value of convertible senior debentures with a stated maturity date of March 15, 2024 (the 2024 Debentures). The Company has \$0.4 million of the 2024 Debentures outstanding at June 30, 2012. On March 21, 2011, the Company repurchased \$30.8 million of the 2024 Debentures as required by the 2024 Debenture holders. Interest on the 2024 Debentures is payable semi-annually. At the debentures holders' option, the 2024 Debentures are convertible into the Company's common stock through March 14, 2024, subject to certain conditions. The adjusted conversion rate of the debentures is \$43.3044 of principal amount per share. The closing price of the Company's common stock at June 30, 2012 was \$15.48. The remaining 2024 Debentures holders have the right to require the Company to repurchase the 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their face amount, plus accrued and unpaid interest. Subject to certain conditions, the Company has the right to redeem all or some of the 2024 Debentures.

At June 30, 2012, the fair value of the \$0.4 million outstanding 2024 Debentures approximated their carrying value based on quoted market prices as of such date.

***Convertible Senior Debentures due 2014***

In March 2010, the Company issued an aggregate of \$46.9 million in face value of convertible senior debentures with a stated maturity of March 15, 2014 (the 2014 Debentures). Interest on the 2014 Debentures is payable semi-annually on March 15 and September 15. In the first quarter of 2010, as required under the terms of the 2014 Debentures, the Company placed approximately \$19.0 million in a restricted escrow account to make all scheduled interest payments on the 2014 Debentures through their maturity. In the six months ended June 30, 2012, interest payments of \$2.4 million were made out of the restricted escrow account and are considered non-cash investing activities. Including accrued interest, a total of \$10.0 million was reflected in Restricted cash equivalents on the Consolidated Balance Sheet at June 30, 2012, of which \$5.2 million was classified as a current asset.

At the debentures holders' option, the 2014 Debentures are convertible into the Company's common stock at anytime after March 15, 2013; and, prior to March 15, 2013, under any of the following conditions:

during any fiscal quarter commencing after June 30, 2010 if the closing sale price per share of Company common stock is greater than or equal to 120% of the conversion price for at least 20 trading days during the period of 30 trading days ending on the last day of the preceding fiscal quarter;

during the five day period immediately following any 10 consecutive trading day period in which the trading price per \$1,000 principal amount of 2014 Debentures for each trading day of such period was less than 100% of the product of the closing sale price per share of Company common stock multiplied by the conversion rate on each such trading day;

If a fundamental change (as defined) occurs, including sale of all or substantially all of the Company's common stock or assets, liquidation, dissolution or a change in control.

The conversion price is \$16.50 of principal amount per share, equivalent to a conversion rate of 60.6061 shares of Company common stock per \$1,000 principal amount of the 2014 Debentures. The closing price of the Company's common stock at June 30, 2012 was \$15.48. The 2014 Debentures holders have the right to require repurchase of the 2014 Debentures upon a fundamental change, including sale of all or substantially all of the Company's common stock or assets, liquidation, dissolution or a change in control or the delisting of the Company's common stock from the New York Stock Exchange if the Company were unable to obtain a listing for its common stock on another national or regional securities exchange. None of the above conditions required for conversion were met as of June 30, 2012.



**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company may mandatorily convert all or some of the 2014 Debentures at any time after March 15, 2012 if the closing sale price per share of Company common stock exceeds 130% of the conversion price for at least 20 trading days in a period of 30 consecutive trading days. If the Company elects to mandatorily convert any of the 2014 Debentures, the Company will be required to pay any interest that would have accrued and become payable on the debentures through their maturity. Upon a conversion of the 2014 Debentures, the Company has the right to settle the conversion in stock, cash or a combination thereof.

Because the 2014 Debentures may be settled in cash or partially in cash upon conversion, the Company separately accounts for the liability and equity components of the 2014 Debentures. The carrying amount of the liability component was determined at the exchange 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 carrying value of the 2014 Debentures as a whole at the exchange date. The carrying value of the 2014 Debentures as a whole at the exchange date was equal to their fair value of \$55.2 million determined using a convertible bond valuation model. At June 30, 2012, the fair value of the \$46.9 million outstanding 2014 Debentures was approximately \$59.4 million based on the midpoint of bid and ask prices as of such date. At June 30, 2012, the carrying amount of the equity component was \$10.8 million, the principal amount of the liability component was \$46.9 million, the unamortized discount was \$1.3 million and the net carrying value of the liability component was \$45.6 million. The Company is amortizing the excess of the face value of the 2014 Debentures over their carrying value to interest expense over their term. The effective interest rate on the 2014 Debentures is 12.5%.

**Credit Arrangements**

The Company is party to a loan agreement 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 lending bank. The credit facility matures on December 31, 2012. 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 has been required in connection with the sale of CompuCom Systems in 2004. Availability under the Company's revolving credit facility at June 30, 2012 was \$43.7 million.

**6. Stock-Based Compensation**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
	(Unaudited)		(Unaudited)	
General and administrative expense	\$ 846	\$ 1,274	\$ 1,229	\$ 2,001
	\$ 846	\$ 1,274	\$ 1,229	\$ 2,001

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.



**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

At June 30, 2012, 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 six months ended June 30, 2012 and 2011, respectively, the Company did not issue any market-based option awards to employees. During the six months ended June 30, 2012 and 2011, respectively, 0 and 58 thousand options vested based on achievement of market capitalization targets. The Company recorded compensation expense related to market-based option awards of \$0.1 million and \$0.4 million for the three months ended June 30, 2012 and 2011, respectively and \$0.2 million and \$0.9 million for the six months ended June 30, 2012 and 2011, respectively. Depending on the Company's stock performance, the maximum number of unvested shares at June 30, 2012 attainable under these grants was 962 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 six months ended June 30, 2012 and 2011, respectively, the Company issued 0 and 64 thousand performance-based awards to employees. During the six months ended June 30, 2012 and 2011 respectively, no performance-based awards vested. The Company recorded compensation expense related to performance-based option awards of \$0.1 million and \$0.2 million for the three months ended June 30, 2012 and 2011 and \$0.1 million and \$0.2 million for the six months ended June 30, 2012 and 2011, respectively. The maximum number of unvested shares at June 30, 2012 attainable under these option grants was 648 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 six months ended June 30, 2012 and 2011, respectively, the Company issued 43 thousand and 61 thousand service-based option awards to employees. The Company recorded compensation expense related to service-based option awards of \$0.3 million for both the three months ended June 30, 2012 and 2011, and \$0.4 million for both the six months ended June 30, 2012 and 2011.

During the six months ended June 30, 2012 and 2011, respectively, the Company issued 22 thousand and 23 thousand deferred stock units to non-employee directors for annual service grants or fees earned during the preceding quarter. Deferred stock units issued to directors in lieu of directors fees are 100% vested at the grant date; matching deferred stock units equal to 25% of directors' fees deferred vest one year following the grant date or, if earlier, upon reaching age 65. Deferred stock units are payable in stock on a one-for-one basis. Payments related to the deferred stock units are generally distributable following termination of employment or service, death or permanent disability.

Total compensation expense for deferred stock units, performance-based stock units and restricted stock was approximately \$0.3 million for both the three months ended June 30, 2012 and 2011, and \$0.5 million for both the six months ended June 30, 2012 and 2011. During the six months

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ended June 30, 2012, the Company issued five thousand unrestricted shares to members of its advisory board, and recorded expense of \$0.1 million related to these awards.



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**SAFEGUARD SCIENTIFICS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**7. Income Taxes**

The Company's consolidated income tax benefit (expense) was \$0.0 million for the three and six months ended June 30, 2012 and 2011. The Company has recorded a valuation allowance to reduce its net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the tax benefit related to net operating losses that would have been recognized in the three and six months ended June 30, 2012 and the tax expense that would have been recognized in the three and six months ended June 30, 2011 were offset by changes in the valuation allowance.

During the three and six months ended June 30, 2012, the Company had no material changes in uncertain tax positions.

**Table of Contents****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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands except per share data)			
	(Unaudited)			
<b>Basic:</b>				
Net income (loss)	\$ (10,137)	\$ 121,815	\$ (19,797)	\$ 112,805
Average common shares outstanding	20,927	20,741	20,903	20,709
Net income (loss) per share	\$ (0.48)	\$ 5.87	\$ (0.95)	\$ 5.45
<b>Diluted:</b>				
Net income (loss)	\$ (10,137)	\$ 121,815	\$ (19,797)	\$ 112,805
Interest on convertible senior debentures		1,384		2,962
Net income (loss) for dilutive share computation	\$ (10,137)	\$ 123,199	\$ (19,797)	\$ 115,767
Number of shares used in basic per share computation	20,927	20,741	20,903	20,709
Convertible senior debentures		2,855		3,166
Unvested restricted stock and deferred stock units		69		78
Employee stock options		709		707
Average common shares outstanding	20,927	24,374	20,903	24,660
Net income (loss) per share	\$ (0.48)	\$ 5.05	\$ (0.95)	\$ 4.69

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**SAFEGUARD SCIENTIFICS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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, warrants or other securities outstanding, diluted net income (loss) per share is computed by first deducting from net income (loss), the income attributable to the potential exercise of the dilutive securities of the partner company. This impact is shown as an adjustment to net income (loss) for purposes of calculating diluted net income (loss) per share.

The following potential shares of common stock and their effects on income (loss) were excluded from the diluted net income (loss) per share calculation for the three months ended June 30, 2012 and 2011 because their effect would be anti-dilutive:

At June 30, 2012, options to purchase 3.2 million shares of common stock, respectively, at prices ranging from \$3.93 to \$18.80 per share, were excluded from the calculations.

At June 30, 2012 and 2011, unvested restricted stock units, performance stock units and DSUs convertible into 0.2 million shares of stock were excluded from the calculations.

At June 30, 2012, 10 thousand shares related to the Company's 2024 Debentures (see Note 5) representing the effect of assumed conversion of the 2024 Debentures were excluded from the calculations.

At June 30, 2012, 2.8 million shares related to the Company's 2014 Debentures (see Note 5) representing the effect of assumed conversion of the 2014 Debentures were excluded from the calculations.

The following potential shares of common stock and their effects on income (loss) were excluded from the diluted net income (loss) per share calculation for the six months ended June 30, 2012 and 2011 because their effect would be anti-dilutive:

At June 30, 2012 options to purchase 3.2 million shares of common stock at prices ranging from \$3.93 to \$18.80 per share, were excluded from the calculations.

At June 30, 2012 and 2011, unvested restricted stock units, performance stock units and DSUs convertible into 0.2 million shares of stock were excluded from the calculations.

At June 30, 2012, 10 thousand shares related to the Company's 2024 Debentures (see Note 5), representing the effect of assumed conversion of the 2024 Debentures, were excluded from the calculations.

At June 30, 2012, 2.8 million shares related to the Company's 2014 Debentures (see Note 5), representing the effect of assumed conversion of the 2014 Debentures, were excluded from the calculations.



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**SAFEGUARD SCIENTIFICS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. Operating Segments**

As of June 30, 2012, the Company held interests in 16 non-consolidated partner companies which are included in either the Life Sciences or Technology segments. Included in the Penn Mezzanine segment are the Company's interest 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 reportable operating segments are Life Sciences, Technology and Penn Mezzanine.

**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company's active partner companies by segment were as follows as of June 30, 2012:

**Life Sciences**

<b>Partner Company</b>	<b>Safeguard Primary Ownership</b>	
	<b>as of June 30, 2012</b>	<b>Accounting Method</b>
Alverix, Inc.	49.6%	Equity
Good Start Genetics, Inc.	29.2%	Equity
Medivo, Inc.	30.0%	Equity
NovaSom, Inc.	30.3%	Equity
NuPathe, Inc.	17.8%	Available-for-sale
PixelOptics, Inc.	24.6%	Equity
Putney, Inc.	27.6%	Equity

**Technology**

<b>Partner Company</b>	<b>Safeguard Primary Ownership</b>	
	<b>as of June 30, 2012</b>	<b>Accounting Method</b>
AdvantEdge Healthcare Solutions, Inc.	40.2%	Equity
Beyond.com, Inc.	38.3%	Equity
Bridgevine, Inc.	22.8%	Equity
DriveFactor Inc. (formerly Crimson Informatics, Inc.)	23.9%	Equity
Hoopla Software, Inc.	25.3%	Equity
Lumesis, Inc.	31.6%	Equity
MediaMath, Inc.	22.4%	Equity (1)
Spongecell, Inc.	23.1%	Equity
ThingWorx, Inc.	30.2%	Equity

- (1) In the first quarter of 2011, the Company's ownership interest in MediaMath increased from 17.3% to 22.4%, above the threshold at which the Company believes it exercises significant influence. Accordingly, the Company changed its method of accounting for MediaMath from the cost method to the equity method.

Management evaluates its Life Sciences and Technology segments' performance based on net income (loss) which is based on the number of partner companies accounted for under the equity method, the Company's voting ownership percentage in these partner companies, the net results of operations of these partner companies, any impairment charges and gains (losses) on the sale of partner companies. Management evaluates the Penn Mezzanine segment performance based on the returns on the mezzanine interests in which the Company participates. 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 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, other income (loss) and equity income (loss) related to private equity fund holdings. Other Items also include income taxes, which are reviewed by management independent of segment results.

As of June 30, 2012 and December 31, 2011, all of the Company's assets were located in the United States.

**Table of Contents****SAFEGUARD SCIENTIFICS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Segment assets in Other Items included primarily cash, cash equivalents, cash held in escrow, and marketable securities of \$247.8 million and \$264.0 million, at June 30, 2012 and December 31, 2011, respectively.

	Three Months Ended June 30, 2012					Total
	Life Sciences	Technology	Penn Mezzanine	Total Segments	Other Items	
	(In thousands) (Unaudited)					
Operating loss	\$	\$	\$ (2)	\$ (2)	\$ (5,146)	\$ (5,148)
Interest income			277	277	318	595
Equity loss	(9,390)	514	(69)	(8,945)	(2)	(8,947)
Net income (loss)	(3,840)	514	(533)	(3,859)	(6,278)	(10,137)
<b>Segment Assets:</b>						
June 30, 2012	61,197	55,042	12,195	128,434	264,452	392,886
December 31, 2011	64,281	46,304	12,965	123,550	283,086	406,636

	Three Months Ended June 30, 2011				Total
	Life Sciences	Technology	Total Segments	Other Items	
	(In thousands) (Unaudited)				
Operating loss	\$	\$	\$	\$ (5,570)	\$ (5,570)
Interest income				324	324
Equity income (loss)	130,466	(1,179)	129,287	(10)	129,277
Net income (loss)	129,691	(1,179)	128,512	(6,697)	121,815

	Six Months Ended June 30, 2012					Total
	Life Sciences	Technology	Penn Mezzanine	Total Segments	Other Items	
	(In thousands) (Unaudited)					
Operating loss	\$	\$	\$ (4)	\$ (4)	\$ (9,887)	\$ (9,891)
Interest income			848	848	646	1,494
Equity loss	(15,431)	(773)	(188)	(16,392)	(3)	(16,395)
Net income (loss)	(6,452)	(773)	(83)	(7,308)	(12,489)	(19,797)

	Six Months Ended June 30, 2011				Total
	Life Sciences	Technology	Total Segments	Other Items	
	(In thousands) (Unaudited)				
Operating loss	\$	\$	\$	\$ (10,454)	\$ (10,454)
Interest income				691	691
Equity income (loss)	131,513	(4,747)	126,766	(54)	126,712
Net income (loss)	130,426	(4,747)	125,679	(12,874)	112,805





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**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. While in the current opinion of the Company the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position or results of operations, no assurance can be given as to the outcome of these actions, and one or more adverse rulings could have a material adverse effect on the Company's consolidated financial position and results of operations or that of its partner companies.

Not including the Laureate Pharma, Inc. lease guaranty described below, the Company had outstanding guarantees of \$3.8 million at June 30, 2012.

The Company has committed capital of approximately \$0.1 million to various 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 certain private equity funds ( clawback ). The maximum clawback the Company could be required to return due to our general partner interest is approximately \$1.3 million, of which \$1.0 million was reflected in Accrued expenses and other current liabilities and \$0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet at June 30, 2012.

The Company's ownership in the funds which have potential clawback liabilities ranges from 19-30%. The clawback liability is joint and several; such that the Company may be required to fund the clawback for other general partners should they default. The funds have taken several steps to reduce the potential liabilities should other general partners default, including withholding all general partner distributions and placing them in escrow and adding rights of set-off among certain funds. The Company believes its potential liability due to the possibility of default by other general partners is remote.

In connection with the Company's May 2008 sale of its equity and debt interests in Acsis, Inc., Alliance Consulting Group Associates, Inc., Laureate Pharma, Inc., ProModel Corporation and Neuronyx, Inc. (the Bundle Transaction ), an aggregate of \$6.4 million of the gross proceeds of the sale were placed in escrow pending the expiration of a predetermined notification period, subject to possible extension in the event of a claim against the escrowed amounts. On April 25, 2009, the purchaser in the Bundle Transaction notified the Company of claims being asserted against the entire escrowed amounts. The Company does not believe that such claims are valid and has instituted legal action to obtain the release of such amounts from escrow. The proceeds being held in escrow will remain there until the dispute over the claims has been settled or determined pursuant to legal process.

The Company remains guarantor of Laureate Pharma's Princeton, New Jersey facility lease. Such guarantee may extend through the lease expiration in 2016 under certain circumstances. However, the Company is entitled to indemnification in connection with the continuation of such guaranty. As of June 30, 2012, scheduled lease payments to be made by Laureate Pharma over the remaining lease term equaled \$5.4 million.

In October 2001, the Company entered into an agreement with its former Chairman and Chief Executive Officer, to provide for annual payments of \$650,000 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 \$2.8 million was included in Other long-term liabilities on the Consolidated Balance Sheet at June 30, 2012.

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 \$8 million at June 30, 2012.



**Table of Contents****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, estimates, should, would, could, will, opportunity, potential or may, variations of such words or other words that convey uncertainty about 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, managing rapidly changing technologies, limited access to capital, competition, the ability to attract and retain qualified employees, the ability to execute our strategy, the uncertainty of the future performance of our partner companies, acquisitions and dispositions of companies, the inability to manage growth, compliance with government regulation and legal liabilities, additional financing requirements, labor disputes and the effect of economic conditions in the business sectors in which our partner companies operate, all of which are discussed in Item 1A. Risk Factors in Safeguard's Annual Report on Form 10-K and updated, as applicable, in 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 growing businesses by providing partner companies with capital and a range of strategic, operational and management resources. Safeguard may participate in expansion financings, corporate spin-outs, management buy-outs, recapitalizations, industry consolidations and early-stage financings. Our vision is to be the preferred catalyst to build great companies across diverse capital platforms.

We strive to create long-term value for our shareholders by helping partner companies increase their market penetration, grow revenue and improve cash flow. We focus principally on companies that operate in two sectors and in which we anticipate deploying up to \$25 million. The two sectors on which we presently focus are:

*Life Sciences* including companies focused on molecular and point-of-care diagnostics, medical devices, specialty pharmaceuticals and selected healthcare services that have lesser regulatory risk and have achieved or are near commercialization; and

*Technology* including companies focused on Internet/new media, financial services IT, healthcare IT, enterprise software and selected business services that have transaction-enabling applications with a recurring revenue stream.

It is our stated intention to continue to develop, grow and extend our capital deployment and business building platform by leveraging our core capabilities. These initiatives may take the form of: i) considering partner companies in additional sectors; ii) making a concerted effort to deploy debt capital to our partner companies or to other borrowers; iii) managing the deployment of capital other than that which originates on our balance sheet; and/or iv) acquiring and maintaining ownership interests in other managers of capital.

**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, 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

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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 June 30, 2012, we did not hold a controlling interest in any of our partner companies.

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

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

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

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

### **Critical Accounting Policies and Estimates**

Accounting policies, methods and estimates are an integral part of the Consolidated Financial Statements prepared by management and are based upon management's current judgments. These judgments are normally based on knowledge and experience with regard to past and current events and assumptions about future events. Certain accounting policies, methods and estimates are particularly important because of their significance to the financial statements and because of the possibility that future events affecting them may differ from management's current judgments. While there are a number of accounting policies, methods and estimates affecting our financial statements as described in Note 1 to our Consolidated 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 and available-for-sale securities for possible impairment based on achievement of business plan objectives and milestones, the financial condition and prospects of the company, market conditions and other relevant factors. The business plan objectives and milestones we consider include, among others, those related to financial performance, such as achievement of planned financial results or completion of capital raising activities, and those that are not primarily financial in nature, such as hiring of key employees or the establishment of strategic relationships. We then determine whether there has been an other than temporary decline in the value of our ownership interest in the company. Impairment to be recognized is measured as the amount by which the carrying value of an asset exceeds its fair value. The adjusted carrying

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value of a partner company is not increased if circumstances suggest the value of the partner company has subsequently recovered.

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

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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 and available-for-sale securities are not impaired, there can be no assurance that our future results will confirm this assessment or that a significant write-down or write-off will not be required in the future.

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

### ***Accounting for participating interests in mezzanine loans receivable and related equity interests***

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

#### ***Loan Participations Receivable***

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

On a quarterly basis, we evaluate the carrying value of each loan participation receivable for impairment. A loan participation receivable is considered impaired when it is probable that we will be unable to collect all amounts (principal and interest) due according to the contractual terms of the participation agreement and related agreements with the borrowers. We maintain an allowance to provide for estimated loan losses based on evaluating known and inherent risks in the loans. The allowance is provided based upon our analysis of the pertinent factors underlying the quality of the loans. These factors include an analysis of the financial condition of the borrowers, delinquency levels, actual loan loss experience, current economic conditions and other relevant factors. Our analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. We do not accrue interest when a loan is considered impaired. All cash receipts from impaired loans are applied to reduce the original principal amount of such loan, until the principal has been fully recovered and would be recognized as interest income thereafter. The allowance for loan losses at June 30, 2012 and December 31, 2011 was \$0.2 million and \$0.0 million, respectively.

#### ***Equity Participations***

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

#### ***Warrant Participations***

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

#### ***Income Taxes***

We are required to estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our Consolidated Balance Sheets. We must assess the likelihood that the deferred tax assets will be recovered from future taxable income and to the extent that we believe recovery is not





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likely, we must establish a valuation allowance. To the extent we establish a valuation allowance in a period, we must include an expense within the tax provision in the Consolidated Statements of Operations. We have recorded a valuation allowance to reduce our deferred tax assets to an amount that is more likely than not to be realized in future years. If we determine in the future that it is more likely than not that the net deferred tax assets would be realized, then the previously provided valuation allowance would be reversed.

### ***Commitments and Contingencies***

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

### ***Stock-Based Compensation***

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

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

**Table of Contents****Results of Operations**

Our reportable operating segments are Life Sciences, Technology and Penn Mezzanine.

Our management evaluates the Life Sciences and Technology segments performance based on net 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, mark-to-market gains and losses for companies accounted for under the fair value method, any impairment charges and gains (losses) on the sale of partner companies.

Our management evaluates the Penn Mezzanine segment performance based on the performance of the debt and equity interests in which we participate. This includes an evaluation of the future cash flows associated with principal, 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.

The following tables reflect our consolidated operating data by reportable segment. Segment results include our share of income or losses for entities accounted for under the equity method, when applicable. Segment results also include impairment charges and gains or losses related to the disposition of partner companies, except for those reported in discontinued operations. 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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Life Sciences	\$ (3,840)	\$ 129,691	\$ (6,452)	\$ 130,426
Technology	514	(1,179)	(773)	(4,747)
Penn Mezzanine	(533)		(83)	
Total segments	(3,859)	128,512	(7,308)	125,679
Other items:				
Corporate operations	(6,278)	(6,697)	(12,489)	(12,874)
Income tax benefit				
Total other items	(6,278)	(6,697)	(12,489)	(12,874)
Net income (loss)	\$ (10,137)	\$ 121,815	\$ (19,797)	\$ 112,805

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

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

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



**Table of Contents****Life Sciences**

The following active partner companies as of June 30, 2012 were included in Life Sciences:

	Safeguard Primary Ownership as of June 30,		Accounting Method
	2012	2011	
Alverix, Inc.	49.6%	49.6%	Equity
Good Start Genetics, Inc.	29.2%	26.3%	Equity
Medivo, Inc.	30.0%	NA	Equity
NovaSom, Inc.	30.3%	31.7%	Equity
NuPathe, Inc.	17.8%	18.1%	Available -for-sale
PixelOptics, Inc.	24.6%	24.7%	Equity
Putney, Inc.	27.6%	NA	Equity

Results of operations for the Life Sciences segment were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Other income (loss), net	\$ 5,550	\$ (775)	\$ 8,979	\$ (1,087)
Equity income (loss)	(9,390)	130,466	(15,431)	131,513
Net income (loss)	\$ (3,840)	\$ 129,691	\$ (6,452)	\$ 130,426

*Three months ended June 30, 2012 versus the three months ended June 30, 2011*

*Other Income (Loss), Net.* Other income (loss), net increased \$6.3 million for the three months ended June 30, 2012, compared to the prior year period. Other income (loss), net for the three months ended June 30, 2012 reflected a \$5.6 million gain recorded in connection with the achievement of the initial milestone associated with the sale of Avid Radiopharmaceuticals, Inc. ( Avid ) to Eli Lilly and Company in December 2010, partially offset by an impairment charge of \$0.1 million on our holdings in Tengion, Inc. ( Tengion ). Other income (loss), net for the three months ended June 30, 2011 reflected an impairment charge of \$0.8 million on our holdings in Tengion.

*Equity Income (Loss).* Equity income (loss) fluctuates with the number of Life Sciences 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 we have 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 income (loss) for Life Sciences decreased \$139.9 million in the three months ended June 30, 2012 compared to the prior year period. The prior year period included a gain of \$129.0 million in connection with the sale of Advanced BioHealing, Inc. ( Advanced BioHealing ) to Shire plc in June 2011. The prior year also included equity income of Advanced BioHealing. The three months ended June 30, 2012 included an impairment charge of \$3.7 million related to PixelOptics, Inc. ( PixelOptics ). The impairment was based upon launch delays and related supply chain issues that PixelOptics is addressing, as well as the pricing of a transaction between other institutional shareholders in PixelOptics. The remaining decrease in equity income was primarily due to an increase in the number of partner companies included in the Life Sciences segment, all of which incurred net losses.

*Six months ended June 30, 2012 versus the six months ended June 30, 2011*

*Other Income (Loss), Net.* Other income (loss), net increased \$10.1 million for the six months ended June 30, 2012, compared to the prior year period. Other income (loss), net for the six months ended June 30, 2012 reflected a \$3.4 million gain recorded in connection with the expiration of the escrow period associated with the sale of Avid to Eli Lilly and Company in December 2010, as well as a \$5.6 million gain related to the achievement of the initial milestone associated with the Avid transaction. These gains were partially offset by an impairment charge of \$0.1

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million on our holdings in Tengion. Other income (loss), net for the six months ended June 30, 2011 reflected an impairment charge of \$1.1 million on our holdings in Tengion.

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*Equity Income (Loss).* Equity income (loss) for Life Sciences increased \$146.9 million in the six months ended June 30, 2012 compared to the prior year period. The prior year period included a gain of \$129.0 million in connection with the sale of Advanced BioHealing to Shire plc in June 2011. The prior year also included equity income of Advanced BioHealing. The six months ended June 30, 2012 included an impairment charge of \$3.7 million related to PixelOptics. The impairment was based upon launch delays and related supply chain issues that PixelOptics is addressing, as well as the pricing of a transaction between other institutional shareholders in PixelOptics. The remaining decrease in equity income was primarily due to an increase in the number of partner companies included in the Life Sciences segment, all of which incurred net losses.

**Technology**

The following active partner companies as of June 30, 2012 were included in Technology:

Partner Company	Safeguard Primary Ownership as of		Accounting Method
	2012	2011	
AdvantEdge Healthcare Solutions, Inc.	40.2%	40.2%	Equity
Beyond.com, Inc.	38.3%	38.3%	Equity
Bridgevine, Inc.	22.8%	22.8%	Equity
DriveFactor (formerly Crimson Informatics, Inc.)	23.9%	NA	Equity
Hoopla Software, Inc.	25.3%	NA	Equity
Lumesis, Inc.	31.6%	NA	Equity
MediaMath, Inc.	22.4%	22.6%	Equity (1)
Spongecell, Inc.	23.1%	NA	Equity
ThingWorx, Inc.	30.2%	30.7%	Equity

- (1) In the first quarter of 2011, our ownership interest in MediaMath increased from 17.3% to 22.4%, above the threshold at which we believe we exercise significant influence. Accordingly, we changed our method of accounting for MediaMath from the cost method to the equity method.

Results of operations for the Technology segment were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Equity income (loss)	\$ 514	\$ (1,179)	\$ (773)	\$ (4,747)
Net income (loss)	\$ 514	\$ (1,179)	\$ (773)	\$ (4,747)

*Three months ended June 30, 2012 versus the three months ended June 30, 2011*

*Equity Income (Loss).* Equity income (loss) fluctuates with the number of Technology partner companies accounted for under the equity method, our voting ownership percentage in these partner companies and the net results of operations of these partner companies. We recognize our share of losses to the extent we have cost basis in the equity partner company or we have 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 income (loss) for the Technology segment increased \$1.7 million in the three months ended June 30, 2012, compared to the prior year period. The increase was related primarily to a \$1.9 million gain recorded in connection with the achievement of certain performance milestones related to the sale of Portico Systems, Inc. ( Portico ) to McKesson in July 2011. The remaining increase was related to smaller losses incurred at partner companies within the Technology segment.



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*Six months ended June 30, 2012 versus the six months ended June 30, 2011*

*Equity Income (Loss).* Equity income (loss) for Technology increased \$4.0 million in the six months ended June 30, 2012, compared to the prior year period. The increase was partially related to a \$1.9 million gain recorded in connection with the achievement of certain performance milestones associated with the sale of Portico to McKesson in July 2011. The prior period included a \$1.4 million impairment charge related to SafeCentral recorded in the first quarter of 2011. The remainder of the increase was related to smaller losses incurred at partner companies within the Technology segment.

Results for the Penn Mezzanine segment were as follows:

	<b>Three Months Ended June 30, 2012</b>	<b>Six Months Ended June 30, 2012</b>
	<b>(In thousands)</b>	<b>(In thousands)</b>
General and administrative expense	\$ (2)	\$ (4)
Interest income	277	848
Other income (loss), net	(739)	(739)
Equity loss	(69)	(188)
<b>Net income</b>	<b>\$ (533)</b>	<b>\$ (83)</b>

Results of the Penn Mezzanine segment include interest, dividends, loan origination and other fees earned on the mezzanine interests in which we participate, any impairment on our debt and equity interests as well as equity income (loss) associated with our interest in the management company and general partner of Penn Mezzanine. As of June 30, 2012, we had a participation in six loan and seven equity interests initiated by Penn Mezzanine. During the six months ended June 30, 2012, we participated in one new mezzanine loan for which the outstanding principal was paid in full by the borrower in the first quarter of 2012. We recognized \$0.2 million in interest, loan origination fees and prepayment penalties associated with this loan participation. During the three months ended June 30, 2012, we recorded an impairment charge associated with our equity and loan participations. Charges associated with our equity, warrant and loan participations were of \$0.4 million, \$0.1 million and \$0.2 million, respectively.



**Table of Contents****Corporate Operations**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
General and administrative expense	\$ (4,270)	\$ (4,264)	\$ (8,598)	\$ (8,389)
Stock-based compensation	(846)	(1,274)	(1,229)	(2,001)
Depreciation	(30)	(32)	(60)	(64)
Interest income	318	324	646	691
Interest expense	(1,456)	(1,441)	(2,908)	(3,077)
Other income (loss), net	8		(337)	20
Equity loss	(2)	(10)	(3)	(54)
	\$ (6,278)	\$ (6,697)	\$ (12,489)	\$ (12,874)

*Three months ended June 30, 2012 versus the three months ended June 30, 2011*

**General and Administrative Expense.** Our general and administrative expenses consist primarily of employee compensation, insurance, outside services such as legal, accounting and travel-related costs. General and administrative expense remained consistent when compared to the prior year period.

**Stock-Based Compensation.** Stock-based compensation consists primarily of expense related to stock option grants and grants of restricted stock and deferred stock units to our employees. Stock-based compensation decreased \$0.4 million compared to the prior year period primarily due to a \$0.3 million decrease in expense related to market-based stock options and a \$0.1 million decrease in expense related to performance-based awards. Expense related to market-based awards is expected to decrease since these awards were granted from 2005 to 2008 and most of the expense related to these awards was previously recognized.

**Interest Income.** Interest income includes all interest earned on available cash and marketable security balances. Interest income remained consistent compared to the prior year period.

**Interest Expense.** Interest expense is primarily related to our convertible senior debentures due in 2024 ( 2024 Debentures ) and in 2014 ( 2014 Debentures ). Interest expense remained consistent compared to the prior year period.

**Equity Loss.** Equity loss for both periods presented related to our private equity holdings accounted for under the equity method.

*Six months ended June 30, 2012 versus the six months ended June 30, 2011*

**General and Administrative Expense.** Our general and administrative expenses consist primarily of employee compensation, insurance, outside services such as legal, accounting and travel-related costs. General and administrative expense increased \$0.2 million when compared to the prior year period. The increase was primarily due to a \$0.1 million increase in employee costs and a \$0.1 million increase in expense related to an ongoing agreement with our former Chairman and Chief Executive Officer.

**Stock-Based Compensation.** Stock-based compensation consists primarily of expense related to stock option grants and grants of restricted stock and deferred stock units to our employees. Stock-based compensation decreased \$0.8 million compared to the prior year period primarily due to a \$0.7 million decrease in expense related to market-based stock options and a \$0.1 million decrease in expense related to performance-based awards.

**Interest Income.** Interest income includes all interest earned on available cash and marketable security balances. Interest income remained consistent compared to the prior year period.

**Interest Expense.** Interest expense is primarily related to our 2024 and 2014 Debentures. The decrease in interest expense of \$0.2 million in the six months ended June 30, 2012 compared to the prior year period is due to lower average convertible debt outstanding in the current year as a result of the repurchase of \$30.8 million of our 2024 Debentures in the first quarter of 2011.

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*Other Income (Loss), Net.* Other income (loss), net decreased \$0.4 million for the six months ended June 30, 2012, compared to the prior year period. Other income (loss), net for the six months ended June 30, 2012 reflected an impairment charge of \$0.4 million related to our interest in a legacy private equity fund.

*Equity Loss.* Equity loss for both periods presented related to our private equity holdings accounted for under the equity method.

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### ***Income Tax Expense (Benefit)***

Income tax benefit (expense) was \$0.0 million for both the three and six months ended June 30, 2012 and 2011. 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 income tax benefit related to the net operating loss that would have been recognized in the three and six months ended June 30, 2012 and the tax expense that would have been recognized in the three and six months ended June 30, 2011 were offset by changes in the valuation allowance.

During the six months ended June 30, 2012, we had no material changes in uncertain tax positions.

### ***Liquidity and Capital Resources***

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

As of June 30, 2012, we had \$58.7 million of cash and cash equivalents and \$182.6 million of short-term and long-term marketable securities for a total of \$241.4 million. In addition, we had \$6.4 million of cash held in escrow, including accrued interest, related to our May 2008 sale of our equity and debt interests in Acsis, Inc., Alliance Consulting Group Associates, Inc., Laureate Pharma, Inc., ProModel Corporation and Neuronyx, Inc. (the Bundle Transaction ) and \$10.0 million was held in a restricted escrow account to service interest on the 2014 Debentures, as discussed below.

Portico was acquired by McKesson in July 2011 and we received cash proceeds of approximately \$32.8 million in exchange for our equity interests, excluding \$3.4 million which was to be held in escrow for a stated period of one year. In June 2012, we received an additional \$1.9 million as a result of the achievement of certain milestones associated with the transaction.

In June 2011, Advanced BioHealing was acquired by Shire plc, resulting in net proceeds of \$138.2 million, excluding \$7.6 million held in escrow. The escrow period expired in March 2012. Prior to the expiration of the escrow period, Shire plc filed a claim against the escrowed funds. No further proceeds will be distributed to us or other former owners until the validity of such claims is determined.

In December 2010, Avid was acquired by Eli Lilly and Company resulting in net proceeds to us of \$32.3 million. In April 2012, we received an additional \$3.4 million in connection with the expiration of the escrow period. Also in April 2012, a regulatory milestone associated with the Avid transaction was achieved which resulted in \$5.6 million of additional proceeds to us in the second quarter of 2012. In addition, depending on the achievement of certain difficult commercial and regulatory milestones, we could receive additional proceeds of up to \$54 million over a seven-year period.

In December 2010, we received cash proceeds of \$2.6 million in connection with the sale of Quinnova Pharmaceuticals, Inc. Under the terms of the sale transaction, depending on the achievement of certain commercial milestones, we could receive additional proceeds of up to \$1.9 million. The buyers in the Quinnova transaction have disputed their obligation regarding any such future payments.

In connection with the Bundle Transaction, an aggregate of \$6.4 million of the gross proceeds of the sale were placed in escrow pending the expiration of a predetermined notification period, subject to possible extension in the event of a claim against the escrowed amounts. On April 25, 2009, the purchaser in the Bundle Transaction notified us of claims being asserted against the entire escrowed amounts. We do not believe that such claims are valid and have instituted legal action to obtain the release of such amounts from escrow. The proceeds being held in escrow will remain there until the dispute over the claims have been settled or determined pursuant to legal process.

In 2004, we issued an aggregate of \$150 million in face value of 2024 Debentures. We have \$0.4 million of the 2024 Debentures outstanding at June 30, 2012. In March 2011, we repurchased \$30.8 million of the 2024 Debentures as required by the Debenture holders. Interest on the 2024 Debentures is payable semi-annually. At the debentures holders' option, the 2024 Debentures are convertible into our common stock through March 14, 2024, subject to certain conditions. The adjusted conversion rate of the debentures is \$43.3044 of principal amount per share. The closing price of our common stock at June 30, 2012 was \$15.48. The remaining 2024 Debentures holders have the right to require us to repurchase the 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their face amount, plus accrued and unpaid interest. Subject to certain conditions, we have the right to redeem all or some of the 2024 Debentures.

In March 2010, we issued \$46.9 million in face value of our 10.125% 2014 Debenture in an exchange transaction for the same face amount of our 2024 Debentures. Interest on the 2014 Debentures is payable semi-annually. As required by the terms of the 2014 Debentures, at issuance

we placed approximately \$19.0 million in a restricted escrow account to service interest associated with the 2014 Debentures

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through their maturity. At the debentures holders' option, the 2014 Debentures are convertible into our common stock prior to March 15, 2013 subject to certain conditions, and at anytime after March 15, 2013. The conversion rate of the 2014 Debentures is \$16.50 of principal amount per share. The closing price of our common stock at June 30, 2012 was \$15.48. The 2014 Debentures holders have the right to require repurchase of the 2014 Debentures upon certain events, including sale of all or substantially all of our common stock or assets, liquidation, dissolution, a change in control or the delisting of our common stock from the New York Stock Exchange if we were unable to obtain a listing for our common stock on another national or regional securities exchange. Subject to certain conditions, we may mandatorily convert all or some of the 2014 Debentures at any time after March 15, 2012. If we elect to mandatorily convert any of the 2014 Debentures, we will be required to pay any interest that would have accrued and become payable on the debentures through their maturity. Upon a conversion of the 2014 Debentures, we have the right to settle the conversion in stock, cash or a combination thereof.

Because the 2014 Debentures may be settled in cash or partially in cash upon conversion, we have separately accounted for the liability and equity components of the 2014 Debentures. The carrying amount of the liability component was determined at the exchange 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 carrying value of the 2014 Debentures as a whole. The carrying value of the 2014 Debentures as a whole was equal to their fair value at the exchange date. We are amortizing the excess of the face value of the 2014 Debentures over their carrying value to interest expense over their term. At June 30, 2012, the fair value of the \$46.9 million outstanding 2014 Debentures was approximately \$59.4 million based on the midpoint of bid and ask prices as of such date.

We are party to a loan agreement 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 lending bank. The credit facility matures on December 31, 2012. 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 has been required in connection with our sale of CompuCom Systems in 2004. Availability under our revolving credit facility at June 30, 2012 was \$43.7 million.

We have committed capital of approximately \$0.1 million to various 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 technology and life sciences 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.

In May 2001, we entered into a \$26.5 million loan agreement with Warren V. Musser, our former Chairman and Chief Executive Officer. Since 2001 and through June 30, 2012, we have received a total of \$16.9 million in payments on the loan. We received cash from the sale of collateral in early 2011 in the amount of \$0.1 million and no payments in 2012. The carrying value of the loan at June 30, 2012 was zero. In December 2011, the loan documents were amended to take into account accumulated unpaid interest and to make certain other changes related to collateral, maturity dates and other terms.

We have received distributions as both a general partner and a limited partner from certain private equity funds. Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner of a fund for further distribution to such fund's limited partners (clawback). The maximum clawback we could be required to return related to our general partner interest is \$1.3 million, of which \$1.0 million was reflected in Accrued expenses and other current liabilities and \$0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet at June 30, 2012.

Our previous ownership in the general partners of the funds that have potential clawback liabilities ranges from 19-30%. The clawback liability is joint and several, such that we may be required to fund the clawback for other general partners should they default. The funds have taken several steps to reduce the potential liabilities should other general partners default, including withholding all general partner distributions and placing them in escrow and adding rights of set-off among certain funds. We believe our potential liability due to the possibility of default by other general partners is remote.

For the reasons we presented above, we believe our cash and cash equivalents at June 30, 2012, 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 commitments to

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our existing 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.

**Table of Contents***Analysis of Consolidated Cash Flows*

Cash flow activity was as follows:

	<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>	
Net cash used in operating activities	\$ (9,624)	\$ (10,392)
Net cash provided by (used in) investing activities	(15,351)	60,912
Net cash provided by (used in) financing activities	513	(30,502)
	\$ (24,462)	\$ 20,018

*Net Cash Used In Operating Activities*

Net cash used in operating activities decreased by \$0.8 million. The change primarily related to \$0.7 million in cash received for interest and fees associated with our participation in mezzanine loans and a \$0.4 million decrease in cash paid for interest as a result of the repurchase of \$30.8 million of the 2024 Debentures in the prior year period, partially offset by a \$0.4 million increase in cash used for management incentive plan payments.

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

Net cash provided by (used in) investing activities decreased by \$76.3 million. The decrease primarily related to a \$126.9 million decrease in proceeds from sales of and distributions from companies and funds and a \$4.4 million increase in advances and loans to companies, partially offset by a \$42.9 million decrease in cash paid to acquire ownership interests in companies and funds, a \$9.1 million net decrease in cash paid to acquire marketable securities and a \$3.1 million increase in repayment of advance to companies. Proceeds from sales of and distributions from companies and funds in the six months ended June 30, 2012 included \$3.4 million and \$5.6 million received in connection with expiration of the escrow period and achievement of the initial milestone associated with the Avid transaction as well as \$1.9 million received in connection with achievement of the milestones associated with the Portico transaction. The six months ended June 30, 2011 included \$137.9 million from the sale of Advanced BioHealing.

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

Net cash provided by (used in) financing activities increased by \$31.0 million. The increase primarily related to the repurchase of \$30.8 million of the 2024 Debentures in the prior year period.

**Table of Contents****Contractual Cash Obligations and Other Commercial Commitments**

The following table summarizes our contractual obligations and other commercial commitments as of June 30, 2012 by period due or expiration of the commitment.

	Total	Payments Due by Period				Due after 2016
		Remainder of 2012	2013 and 2014 (In millions)	2015 and 2016		
<b>Contractual Cash Obligations:</b>						
Convertible senior debentures(a)	\$ 47.3	\$	\$ 47.3	\$	\$	
Operating leases	1.4	0.3	1.0	0.1		
Funding commitments(b)	0.1	0.1				
Potential clawback liabilities(c)	1.3	1.0	0.3			
Other long-term obligations(d)	3.7	0.4	1.6	1.6	0.1	
<b>Total Contractual Cash Obligations</b>	<b>\$ 53.8</b>	<b>\$ 1.8</b>	<b>\$ 50.2</b>	<b>\$ 1.7</b>	<b>\$ 0.1</b>	

	Total	Amount of Commitment Expiration by Period				After 2016
		Remainder of 2012	2013 and 2014 (In millions)	2015 and 2016		
<b>Other Commitments:</b>						
Letters of credit(e)	\$ 6.3	\$	\$	\$	\$ 6.3	

- (a) We have outstanding \$0.4 million of 2024 Debentures with a stated maturity of March 15, 2024. In March 2011, we repurchased \$30.8 million of the 2024 Debentures as required by the 2024 Debenture holders. The holders of the remaining 2024 Debentures have the right to require us to repurchase the remaining 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount, plus accrued and unpaid interest. In March 2010, we issued \$46.9 million in face value of our 10.125% 2014 Debentures in an exchange transaction for the same face amount of our 2024 Debentures.
- (b) These represent funding commitments to private equity funds which have been included in the respective years based on estimated timing of capital calls provided to us by the funds' management.
- (c) We have received distributions as both a general partner and a limited partner from certain private equity funds. Under 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). 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 Sheets.
- (d) Reflects the estimated amount payable to our 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 \$8 million at June 30, 2012.



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We remain guarantor of Laureate Pharma's Princeton, New Jersey facility lease. Such guarantee may extend through the lease expiration in 2016 under certain circumstances. However, we are entitled to indemnification in connection with the continuation of such guaranty. As of June 30, 2012, scheduled lease payments to be made by Laureate Pharma over the remaining lease term equaled \$5.4 million.

As of June 30, 2012, we had federal net operating loss carryforwards totaling approximately \$159.2 million. The net operating loss carryforwards expire in various amounts from 2021 to 2030.

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

### **Factors That May Affect Future Results**

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

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

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

most of our partner companies have a history of operating losses and/or limited operating history;

the intense competition affecting the products and services our partner companies offer could adversely affect their businesses, financial condition, results of operations and prospects for growth;

the inability to adapt to changing marketplaces;

the inability to manage growth;

the need for additional capital to fund their operations, which we may not be able to fund or which may not be available from third parties on acceptable terms, if at all;

the inability to protect their proprietary rights and/or infringing on the proprietary rights of others;

that certain of our partner companies could face legal liabilities from claims made against them based upon their operations, products or work;

the impact of economic downturns on their operations, results and growth prospects;

the inability to attract and retain qualified personnel;

the existence of government regulations and legal uncertainties may place financial burdens on the businesses of our partner companies; and

the inability to plan for and manage catastrophic events.

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

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

As part of our strategy, we continually assess the value to our shareholders of our interests in our partner companies. We also regularly evaluate alternative uses for our capital resources. As a result, depending on market conditions, growth prospects and other key factors, we may at any time:

change the individual and/or types of partner companies on which we focus;

sell some or all of our interests in any of our partner companies; or

otherwise change the nature of our interests in our partner companies.

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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, or plan, upon the receipt of operating cash flows from our partner companies. Our partner companies generally provide us with no cash flow from their operations. We rely on cash on hand, liquidity events and our ability to generate cash from capital raising activities to finance our operations.***

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

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

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

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

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

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

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

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

***Our success is dependent on our executive management.***

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

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

Our strategy involves creating value for our shareholders by helping our partner companies build value and, if appropriate, accessing the public and private capital markets. Therefore, our success is dependent on the value of our partner companies as determined by the public and private capital markets. Many factors, including reduced market interest, may cause the market value of our publicly traded 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.

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***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

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 purpose 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 the Company.***

Events in the United States and international capital markets, debt markets and economies may negatively impact the Company's ability to pursue certain tactical and strategic initiatives, such as accessing additional public or private equity or debt financing for itself or for its partner companies and selling the Company's interests in partner companies on terms acceptable to the Company 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 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 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 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.

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

There is intense competition in the technology and life sciences 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, etc. Despite all of our efforts to understand the research and development underlying the innovation or creation of such technologies, etc. before we deploy capital to a partner company, sometimes the performance of the technology, device, etc. doesn't match the expectations of us or the partner company. In those situations, it is likely that we will incur a partial or total loss of the capital which we deployed in such partner company.

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

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

The technology and life sciences 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.



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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, if at all. Because our resources and our ability to raise capital are not unlimited, we may not be able to provide partner companies with sufficient capital resources to enable them to reach a cash-flow positive position, even if we wished 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 to 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, affect the ability of the Company to realize the value of its capital deployments in such 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 systematic 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 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



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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, as consultants, 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. At present, none of our partner companies have employees represented by labor unions. 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 our partner companies. If Medicare or private payors change the rates at which our partner companies or their customers are reimbursed by insurance providers for their products, such changes could adversely impact our partner companies.

***Some of our partner companies are subject to significant environmental, health and safety regulation.***

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

***Catastrophic events may disrupt our partner companies' business.***

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 they 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 them from fulfilling customer orders or maintaining certain service level requirements, particularly in respect of their SaaS offerings. While certain of our partner companies have developed certain disaster recovery plans and maintain backup systems to reduce the potentially adverse effect of such events, a catastrophic event that resulted in the destruction or disruption of any of their data centers or their critical business or information technology systems could severely affect their ability to conduct normal business operations and, as a result, their business, operating results and financial condition could be adversely affected.

We cannot provide assurance that our partner companies' disaster recovery plans will address all of the issues they may encounter in the event of a disaster or other unanticipated issue, and their business interruption insurance may not adequately compensate them for losses that may occur from any of the foregoing. In the event that a natural disaster, terrorist attack, or other catastrophic event were to destroy any part of their facilities or interrupt their operations for any extended period of time, or if harsh weather or health conditions prevent them from delivering

products in a timely manner, their business, financial condition and operating results could be adversely affected.

**Risks Related to Our Initiatives to Expand Our Platform**

*Our involvement in the mezzanine lending industry through our relationship with Penn Mezzanine could expose us to risks that differ from, and may be in addition to, to the risks that otherwise relate to our other business initiatives.*

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**Table of Contents*****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 higher 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.

***Subordination***

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

***Debt Securities***

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

***Leverage***

Our Penn Mezzanine participations are expected to include borrowers with significant levels of debt. Such situations are inherently more sensitive than others to declines in revenues and to increases in expenses and interest rates. The leveraged capital structure of such borrowers will increase the exposure of those borrowers to bad business planning, adverse economic factors (or other factors) such as downturns in the economy or deterioration in the condition of the borrower or its industry. Because these participations involve subordinated obligations, among the most junior in a borrower's capital structure, the inability of a borrower to service its debt obligations could result in a loss of our principal.

***Minority Positions***

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

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to equity price risks on the marketable portion of our ownership interests in our holdings. At June 30, 2012, these interests include our equity positions in NuPathe, Inc. and Tengion, Inc., both publicly traded entities, which have experienced significant volatility in their stock prices. Historically, we have not attempted to reduce or eliminate our market exposure related to these interests. Based on closing market prices at June 30, 2012, the aggregate fair market value of our holdings in NuPathe and Tengion was approximately \$11.0 million. A 20% decrease in each of NuPathe's and Tengion's stock prices would result in an approximate \$2.2 million decrease in the fair value of our public company holdings.

We have outstanding \$0.4 million of 2024 Debentures with a stated maturity of March 15, 2024. On March 21, 2011, we repurchased \$30.8 million of the 2024 Debentures as required by the 2024 Debenture holders. The 2024 Debenture holders have the right to require the Company to repurchase the 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount, plus accrued and unpaid interest. In March 2010, we issued \$46.9 million in face value of our 10.125% 2014 Debentures in an exchange transaction for the same face amount of our 2024 Debentures.

Liabilities	Remainder of 2012	2013	2014	After 2014	Fair Value at June 30, 2012
2024 Debentures due by year (in millions)	\$	\$	\$ 0.4	\$	\$ 0.4
Fixed interest rate	2.625%	2.625%	2.625%	2.625%	N/A
Interest expense (in millions)	\$	\$	\$	\$	N/A
2014 Debentures due by year (in millions)	\$	\$	\$ 46.9	\$	59.4
Fixed interest rate	10.125%	10.125%	10.125%	10.125%	N/A
Interest expense (in millions)	\$ 2.4	\$ 4.8	\$ 1.0	\$	N/A

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**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 June 30, 2012 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.

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**PART II**

**OTHER INFORMATION**

**Item 1A. *Risk Factors***

Except as set forth below, 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, 2011.



**Table of Contents****Item 6. Exhibits**

## (a) Exhibits.

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

Exhibit Number	Description	Incorporated Filing Reference	
		Form Type & Filing Date	Original Exhibit Number
31.1	Certification of Peter J. Boni pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934		
31.2	Certification of Stephen T. Zarrilli pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934		
32.1	Certification of Peter J. Boni 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 Stephen T. Zarrilli 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 June 30, 2012, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets (unaudited) June 30, 2012 and December 31, 2011; (ii) Consolidated Statements of Operations (unaudited) Three and six months ended June 30, 2012 and 2011; (iii) Consolidated Statements of Comprehensive Income (Loss) (unaudited) - Three and six months ended June 30, 2012 and 2011; (iv) Condensed Statements of Cash Flows (unaudited) Six months ended June 30, 2012 and 2011; (v) Consolidated Statement of Changes in Equity (unaudited) Six months ended June 30, 2012; and (vi) Notes to Consolidated Financial Statements (unaudited)*.		

Filed herewith

\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SAFEGUARD SCIENTIFICS, INC.

Date: July 27, 2012

PETER J. BONI  
Peter J. Boni  
*President and Chief Executive Officer*

Date: July 27, 2012

STEPHEN T. ZARRILLI  
Stephen T. Zarrilli  
*Senior Vice President and Chief Financial Officer*