

SAFEGUARD SCIENTIFICS INC

Form 10-Q

August 11, 2008

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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, 2008**

**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.)*

**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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

Yes  No

**Number of shares outstanding as of August 7, 2008**  
**Common Stock 120,994,944**

**SAFEGUARD SCIENTIFICS, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
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**SAFEGUARD SCIENTIFICS, INC.  
CONSOLIDATED BALANCE SHEETS**

|   | <b>June 30,<br/>2008</b>                         | <b>December<br/>31,<br/>2007</b> |
|---|--|----------------------------------|
|   | <b>(In thousands, except per<br/>share data)</b> |                                  |
|   | <b>(unaudited)</b>                               |                                  |
| <b>ASSETS</b>   |  |                                  |
| Current Assets:   |  |                                  |
| Cash and cash equivalents   | \$ 152,585                                       | \$ 96,201                        |
| Cash held in escrow    current  | 6,407  | 20,345                           |
| Marketable securities   | 2,191  | 590                              |
| Restricted marketable securities  | 3,933  | 3,904                            |
| Accounts receivable, less allowances (\$3,947    2008; \$3,370    2007) | 16,443   | 12,702                           |
| Prepaid expenses and other current assets                               | 1,684  | 1,755                            |
| Assets held for sale  |  | 1,465                            |
| Current assets of discontinued operations                               |  | 32,867                           |
| <br>  |  |                                  |
| Total current assets  | 183,243  | 169,829                          |
| Property and equipment, net   | 12,184   | 11,714                           |
| Ownership interests in and advances to partner companies                | 87,117   | 91,538                           |
| Long-term restricted marketable securities                              |  | 1,949                            |
| Goodwill  | 12,729   | 12,729                           |
| Cash held in escrow    long-term  | 2,352  | 2,341                            |
| Other   | 1,773  | 2,342                            |
| Non-current assets of discontinued operations                           |  | 99,420                           |
| <br>  |  |                                  |
| Total Assets  | \$ 299,398                                       | \$ 391,862                       |
| <br><b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                          |  |                                  |
| Current Liabilities:  |  |                                  |
| Current portion of credit line borrowings                               | \$ 9,000   | \$ 13,997                        |
| Current maturities of long-term debt                                    | 221  | 1,510                            |
| Accounts payable  | 2,734  | 3,134                            |
| Accrued compensation and benefits                                       | 6,042  | 6,934                            |
| Accrued expenses and other current liabilities                          | 12,163   | 14,203                           |
| Current liabilities of discontinued operations                          |  | 50,132                           |
| <br>  |  |                                  |
| Total current liabilities   | 30,160   | 89,910                           |
| Long-term debt  | 400  | 906                              |
| Other long-term liabilities   | 9,391  | 9,111                            |
| Convertible senior debentures   | 129,000  | 129,000                          |
| Minority interest   | 743  | 2,296                            |
| Non-current liabilities of discontinued operations                      |  | 5,916                            |
| Commitments and contingencies   |  |                                  |
| Redeemable consolidated partner company stock-based compensation        |  | 84                               |

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Shareholders' Equity:

Preferred stock, \$0.10 par value; 1,000 shares authorized

Common stock, \$0.10 par value; 500,000 shares authorized; 121,589 and

121,123 shares issued and outstanding in 2008 and 2007, respectively

Additional paid-in capital

Accumulated deficit

Accumulated other comprehensive income

Treasury stock, at cost

Total shareholders' equity

Total Liabilities and Shareholders' Equity

|            |            |
|------------|------------|
| 12,159     | 12,112     |
| 760,739    | 758,515    |
| (642,971)  | (616,013)  |
| (31)       | 25         |
| (192)      |            |
| 129,704    | 154,639    |
| \$ 299,398 | \$ 391,862 |

See Notes to Consolidated Financial Statements.

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**SAFEGUARD SCIENTIFICS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

|   | Three Months Ended<br>June 30,                       |             | Six Months Ended June<br>30, |             |
|---|--|-------------|------------------------------|-------------|
|   | 2008   | 2007        | 2008                         | 2007        |
|   | (In thousands, except per share data)<br>(unaudited) |             |                              |             |
| Revenue   | \$ 16,916  | \$ 9,873    | \$ 32,802                    | \$ 18,702   |
| Operating Expenses:                                       |  |             |                              |             |
| Cost of sales   | 6,895  | 5,519       | 13,003                       | 10,616      |
| Selling, general and administrative                       | 15,881   | 12,591      | 31,126                       | 25,891      |
| Total operating expenses                                  | 22,776   | 18,110      | 44,129                       | 36,507      |
| Operating loss  | (5,860)  | (8,237)     | (11,327)                     | (17,805)    |
| Other income (loss), net                                  | 2,263  | (788)       | 2,623                        | (689)       |
| Interest income   | 790  | 2,169       | 1,719                        | 4,308       |
| Recovery related party                                    | 3  |             | 4                            |             |
| Interest expense  | (1,191)  | (1,317)     | (2,565)                      | (2,769)     |
| Equity loss   | (5,177)  | (3,450)     | (11,464)                     | (5,179)     |
| Minority interest   | 1,769  | 1,304       | 2,156                        | 2,954       |
| Net loss from continuing operations before income taxes   | (7,403)  | (10,319)    | (18,854)                     | (19,180)    |
| Income tax (expense) benefit                              | (4)  | 710         | (4)                          | 696         |
| Net loss from continuing operations                       | (7,407)  | (9,609)     | (18,858)                     | (18,484)    |
| Loss from discontinued operations, net of tax             | (1,024)  | (4,232)     | (8,100)                      | (7,039)     |
| Net loss  | \$ (8,431)   | \$ (13,841) | \$ (26,958)                  | \$ (25,523) |
| Basic and Diluted Loss Per Share:                         |  |             |                              |             |
| Net loss from continuing operations                       | \$ (0.06)  | \$ (0.08)   | \$ (0.15)                    | \$ (0.15)   |
| Net loss from discontinued operations                     | (0.01)   | (0.03)      | (0.07)                       | (0.06)      |
| Net loss per share  | \$ (0.07)  | \$ (0.11)   | \$ (0.22)                    | \$ (0.21)   |
| Shares used in computing basic and diluted loss per share | 123,111  | 122,338     | 123,054                      | 122,227     |

See Notes to Consolidated Financial Statements.

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**SAFEGUARD SCIENTIFICS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | <b>Six Months Ended March<br/>31,</b> |             |
|---|---------------------------------------|-------------|
|   | <b>2008</b>                           | <b>2007</b> |
|   | <b>(In thousands)<br/>(unaudited)</b> |             |
| <b>Cash Flows from Operating Activities:</b>  |                                       |             |
| Cash flows from operating activities of continuing operations   | \$ (10,087)                           | \$ (15,704) |
| Cash flows from operating activities of discontinued operations   | (3,288)                               | (8,434)     |
| Net cash used in operating activities   | (13,375)                              | (24,138)    |
| <b>Cash Flows from Investing Activities:</b>  |                                       |             |
| Proceeds from sales of and distributions from companies and funds   | 3,496                                 | 2,304       |
| Acquisitions of ownership interests in partner companies and funds, net of cash acquired  | (7,168)                               | (41,309)    |
| Advances to companies   | (1,020)                               | (191)       |
| Repayments of note receivable related party   | 4                                     |             |
| Increase in marketable securities   | (3,455)                               | (126,176)   |
| Decrease in marketable securities   | 1,854                                 | 166,523     |
| Capital expenditures  | (2,270)                               | (1,936)     |
| Capitalized software costs  |                                       | (120)       |
| Proceeds from sale of discontinued operations, net  | 83,798                                | 29,967      |
| Cash flows from investing activities of discontinued operations   | (2,867)                               | (5,603)     |
| Net cash provided by investing activities   | 72,372                                | 23,459      |
| <b>Cash Flows from Financing Activities:</b>  |                                       |             |
| Borrowings on revolving credit facilities   | 10,543                                | 11,825      |
| Repayments on revolving credit facilities   | (15,540)                              | (9,455)     |
| Borrowings on term debt   | 672                                   |             |
| Repayments on term debt   | (2,467)                               | (1,098)     |
| Issuance of Company common stock, net   | 64                                    | 539         |
| Issuance of consolidated partner company common stock, net  | 603                                   | 268         |
| Repurchase of Company common stock  | (223)                                 |             |
| Cash flows from financing activities of discontinued operations   | 4,790                                 | 9,767       |
| Net cash (used in) provided by financing activities   | (1,558)                               | 11,846      |
| Net Increase in Cash and Cash Equivalents   | 57,439                                | 11,167      |
| Changes in cash and cash equivalents from, and advances to Acsis, Alliance Consulting, Laureate Pharma and Pacific Title & Art Studio included in assets of discontinued operations | (1,055)                               | 3,023       |
| Cash and Cash Equivalents at beginning of period  | 96,201                                | 60,381      |

|  |            |           |
|--|------------|-----------|
| Cash and Cash Equivalents at end of period | \$ 152,585 | \$ 74,571 |
|--|------------|-----------|

See Notes to Consolidated Financial Statements.

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

**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 statements 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 included together with the Company's Consolidated Financial Statements and Notes thereto included in the Company's 2007 Annual Report on Form 10-K.

**2. BASIS OF PRESENTATION**

The Consolidated Financial Statements include the accounts of the Company and all partner companies in which it directly or indirectly owns more than 50% of the outstanding voting securities during the periods presented.

The Company's Consolidated Statements of Operations for the three and six months ended June 30, 2008 and 2007, Consolidated Statements of Cash Flows for the six months ended June 30, 2008 and 2007 and Consolidated Balance Sheets at June 30, 2008 and December 31, 2007 include Clariant, Inc. (Clariant) in continuing operations.

On May 6, 2008 the Company consummated a transaction (the Bundle Transaction) pursuant to which it sold all of its equity and debt interests in Acsis, Inc. (Acsis), Alliance Consulting Group Associates, Inc. (Alliance Consulting), Laureate Pharma, Inc. (Laureate Pharma), ProModel Corporation (Promodel) and Neuronix, Inc. (Neuronix) (collectively, the Bundle Companies).

During the first quarter of 2007, Pacific Title & Art Studio and Clariant's technology group were sold.

See Note 3 for discontinued operations treatment of Acsis, Alliance Consulting, Laureate Pharma, Pacific Title & Art Studio and Clariant's technology group.

**3. DISCONTINUED OPERATIONS*****Acsis, Alliance Consulting and Laureate Pharma***

Of the companies included in the Bundle Transaction, Acsis, Alliance Consulting and Laureate Pharma were majority-owned partner companies; Neuronix and ProModel were minority-owned partner companies. The Company has presented the results of operations of Acsis, Alliance Consulting and Laureate Pharma as discontinued operations for all periods presented. Goodwill of \$48.9 million related to Alliance Consulting and \$11.5 million related to Acsis was included in discontinued operations at December 31, 2007.

In the first quarter of 2008, the Company recognized an impairment loss of \$3.6 million to write down the aggregate carrying value of the Bundle Companies to the total anticipated proceeds, less estimated costs to complete the Bundle Transaction. In the second quarter of 2008, prior to the completion of the Bundle Transaction, the Company recorded a net loss of \$1.6 million in discontinued operations related to the operations of Acsis, Alliance Consulting and Laureate Pharma. In the second quarter of 2008 the Company recorded a charge of \$0.9 million in discontinued operations to accrue for severance payments due to the former CEO of Alliance Consulting in connection with the Bundle Transaction and recorded a pre-tax gain on disposal of \$1.4 million which is also recorded in discontinued operations.

The gross proceeds to the Company from the Bundle Transaction were \$74.5 million, of which \$6.4 million is to be held in escrow through April, 2009, plus amounts advanced to certain of the Bundle Companies during the time between the signing of the Bundle Transaction agreement and its consummation. Guarantees of partner company credit facilities by the Company of \$31.5 million were eliminated upon the closing of the Bundle Transaction.



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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

***Pacific Title & Art Studio***

In March 2007, the Company sold Pacific Title & Art Studio for net cash proceeds of approximately \$21.9 million, including \$2.3 million cash held in escrow. As a result of the sale, the Company recorded a pre-tax gain of \$2.7 million in the first quarter of 2007. During the first quarter of 2008, the Company recorded a loss of \$0.5 million, which is included within Loss from discontinued operations in the Consolidated Statements of Operations for the six months ended June 30, 2008, to accrue for additional amounts paid in April 2008 to the former CEO of Pacific Title & Art Studio in connection with the March 2007 sale (see Note 15). Pacific Title & Art Studio is reported in discontinued operations for all periods presented.

***Clariant Technology Group***

In March 2007, Clariant sold its technology group (which developed, manufactured and marketed the ACIS Automated Image Analysis System) and related intellectual property to Carl Zeiss MicroImaging, Inc. (the ACIS Sale) for net cash proceeds of \$11.0 million (excluding \$1.5 million in contingent purchase price). As a result of the sale, Clariant recorded a pre-tax gain of \$3.6 million in the first quarter of 2007. The technology group is reported in discontinued operations for all periods presented. Goodwill of \$2.1 million related to the technology group was included in discontinued operations at December 31, 2007.

Results of all discontinued operations were as follows:

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended June</b> |             |
|--|---------------------------|-------------|------------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>30,</b>                   |             |
|  | <b>2008</b>               | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
|  | <b>(In thousands)</b>     |             |                              |             |
|  | <b>(unaudited)</b>        |             |                              |             |
| Revenue  | \$ 12,015                 | \$ 33,396   | \$ 45,712                    | \$ 71,374   |
| Operating expenses                                 | (13,466)                  | (37,157)    | (49,668)                     | (81,641)    |
| Impairment of carrying value                       |                           |             | (3,634)                      |             |
| Other  | (1,054)                   | (475)       | (1,547)                      | (956)       |
| Net loss before income taxes and minority interest | (2,505)                   | (4,236)     | (9,137)                      | (11,223)    |
| Income tax benefit                                 |                           |             |                              | 8           |
| Loss from operations                               | (2,505)                   | (4,236)     | (9,137)                      | (11,215)    |
| Gain (loss) on disposal, net of tax                | 1,478                     | (36)        | 1,020                        | 6,292       |
| Minority interest                                  | 3                         | 40          | 17                           | (2,116)     |
| Loss from discontinued operations, net of tax      | \$ (1,024)                | \$ (4,232)  | \$ (8,100)                   | \$ (7,039)  |

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

The assets and liabilities of discontinued operations were as follows:

|                                      | <b>December 31,<br/>2007</b> |
|--------------------------------------|------------------------------|
| Cash                                 | \$ 3,764                     |
| Accounts receivable, less allowances | 24,858                       |
| Inventory                            | 3,333                        |
| Other current assets                 | 912                          |
| <b>Total current assets</b>          | <b>32,867</b>                |
| Property and equipment, net          | 23,859                       |
| Intangibles                          | 9,960                        |
| Goodwill                             | 64,095                       |
| Other assets                         | 1,506                        |
| <b>Total Assets</b>                  | <b>\$ 132,287</b>            |
| <br>                                 |                              |
| Current portion of long-term debt    | \$ 28,257                    |
| Accounts payable                     | 4,520                        |
| Accrued expenses                     | 10,774                       |
| Deferred revenue                     | 6,100                        |
| Other current liabilities            | 481                          |
| <b>Total current liabilities</b>     | <b>50,132</b>                |
| Long-term debt                       | 3,840                        |
| Minority interest                    | 396                          |
| Deferred income taxes                | 1,026                        |
| Other long-term liabilities          | 654                          |
| <b>Total Liabilities</b>             | <b>\$ 56,048</b>             |
| <br>                                 |                              |
| Carrying value                       | \$ 76,239                    |

**4. MARKETABLE SECURITIES**

Marketable securities included the following:

|                   | <b>Current</b>               |                                  | <b>Non-Current</b>           |                                  |
|-------------------|------------------------------|----------------------------------|------------------------------|----------------------------------|
|                   | <b>June<br/>30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> | <b>June<br/>30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> |
|                   | <b>(In thousands)</b>        |                                  |                              |                                  |
|                   | <b>(unaudited)</b>           |                                  | <b>(unaudited)</b>           |                                  |
| Held-to-maturity: |                              |                                  |                              |                                  |
| Commercial paper  | \$ 1,891                     | \$ 590                           | \$                           | \$                               |

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|                                     |          |          |    |          |
|-------------------------------------|----------|----------|----|----------|
| Certificates of deposit             | 300      |          |    |          |
| Restricted U.S. Treasury securities | 3,933    | 3,904    |    | 1,949    |
|                                     | \$ 6,124 | \$ 4,494 | \$ | \$ 1,949 |

As of June 30, 2008, the contractual maturities of all securities were less than one year.

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

**5. RECENT ACCOUNTING PRONOUNCEMENTS**

In June 2007, the AICPA issued Statement of Position 07-1, Clarification of the Scope of the Audit and Accounting Guide: Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies ( SOP 07-1 ). SOP 07-1 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide: Investment Companies (the Guide ). SOP 07-1 amends the Guide to include criteria for determining whether an entity is an investment company for accounting purposes and is therefore within the Guide s scope. Those criteria include a definition of an investment company and factors to consider in determining whether an entity meets that definition. Entities meeting the definition of an investment company, as well as entities regulated by the Investment Company Act of 1940 or similar requirements, are required to follow the Guide s specialized accounting guidance. In October 2007, the Financial Accounting Standards Board ( FASB ) indefinitely delayed the effective date of SOP 07-01.

In February 2007, the FASB issued SFAS No. 159, Fair Value Option for Financial Assets and Liabilities ( SFAS No. 159 ). SFAS No. 159 allows companies to choose, at specific election dates, to measure eligible financial assets and liabilities that are not otherwise required to be measured at fair value, at fair value. Under SFAS No. 159, companies would report unrealized gains and losses for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize up-front costs and fees related to those items in earnings as incurred. SFAS No. 159 became effective for fiscal years beginning after November 15, 2007. The adoption of SFAS No. 159 did not have a material impact on the Company s consolidated financial statements due to its election to not measure partner company holdings at fair value.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. The requirements of SFAS No. 157 became effective for fiscal years beginning after November 15, 2007. However, in February 2008, the FASB decided that an entity need not apply this standard to nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis until the subsequent year. The adoption of SFAS No. 157 did not have a material impact on the Company s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ( SFAS 141(R) ). SFAS No. 141(R) significantly changes the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date at fair value with limited exceptions. SFAS No. 141(R) further changes the accounting treatment for certain specific items, including:

- § Acquisition costs will be generally expensed as incurred;
- § Noncontrolling interests (formerly known as minority interests see SFAS No. 160 discussion below) will be valued at fair value at the acquisition date;
- § Acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies;
- § In-process research and development (IPR&D) will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date;
- § Restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and

§ Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense.

SFAS No. 141(R) includes a substantial number of new disclosure requirements. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 ( SFAS No. 160 ). SFAS No. 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

recognition of noncontrolling interests (minority interests) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to noncontrolling interests will be included in consolidated net income on the face of the income statement. SFAS No. 160 clarifies that changes in a parent's ownership interest in a subsidiary that does not result in deconsolidation are treated as equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years beginning after November 15, 2008. The adoption of SFAS No. 160 will result in the reclassification of minority interests from long term liabilities to shareholders' equity. Minority interest at June 30, 2008 was \$0.7 million.

In May 2008, the FASB issued Statement No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS No. 162). SFAS No. 162 identifies the sources for generally accepted accounting principles (GAAP) in the U.S. and lists the categories in descending order. An entity should follow the highest category of GAAP applicable for each of its accounting transactions. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The adoption of SFAS No. 162 will not have a material effect on the Company's consolidated financial statements.

**6. COMPREHENSIVE LOSS**

Comprehensive loss is the change in equity of a business enterprise from transactions and other events and circumstances from non-owner sources. Excluding net loss, the Company's sources of comprehensive loss are from net unrealized appreciation (depreciation) on available-for-sale securities and foreign currency translation adjustments. Reclassification adjustments result from the recognition in net income (loss) of unrealized gains or losses that were included in comprehensive income (loss) in prior periods.

The following summarizes the components of comprehensive loss:

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended June</b> |             |
|--|---------------------------|-------------|------------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>30,</b>                   |             |
|  | <b>2008</b>               | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
|  | <b>(In thousands)</b>     |             |                              |             |
|  | <b>(unaudited)</b>        |             |                              |             |
| Net loss from continuing operations                        | \$ (7,407)                | \$ (9,609)  | \$ (18,858)                  | \$ (18,484) |
| Other comprehensive loss:                                  |                           |             |                              |             |
| Foreign currency translation adjustments                   |                           | (60)        | (2)                          | (61)        |
| Unrealized holding losses on available-for-sale securities |                           | (65)        |                              | (487)       |
| Other comprehensive loss from continuing operations        |                           | (125)       | (2)                          | (548)       |
| Comprehensive loss from continuing operations              | (7,407)                   | (9,734)     | (18,860)                     | (19,032)    |
| Net loss from discontinued operations                      | (1,024)                   | (4,232)     | (8,100)                      | (7,039)     |
| Other comprehensive income from discontinued operations    | (29)                      | 15          | (26)                         | 16          |
| Comprehensive loss   | \$ (8,460)                | \$ (13,951) | \$ (26,986)                  | \$ (26,055) |





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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

**7. LONG-TERM DEBT AND CREDIT ARRANGEMENTS**

Consolidated long-term debt consisted of the following:

***Continuing Operations:***

|   | <b>June<br/>30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> |
|---|------------------------------|----------------------------------|
|   | <b>(In thousands)</b>        |                                  |
|   | <b>(unaudited)</b>           |                                  |
| Consolidated partner company credit line borrowings (guaranteed by the Company)     | \$ 9,000                     | \$ 9,000                         |
| Consolidated partner company credit line borrowings (not guaranteed by the Company) |                              | 4,997                            |
|   | 9,000                        | 13,997                           |
| Capital lease obligations and other borrowings                                      | 621                          | 2,416                            |
|   | 9,621                        | 16,413                           |
| Less current maturities   | (9,221)                      | (15,507)                         |
| Total long-term debt of continuing operations, less current portion                 | \$ 400                       | \$ 906                           |

***Discontinued Operations:***

|  | <b>December 31,<br/>2007</b> |          |
|--|------------------------------|----------|
|  | <b>(In<br/>thousands)</b>    |          |
| Consolidated partner company credit line borrowings (guaranteed by the Company)          | \$                           | 18,500   |
| Consolidated partner company credit line borrowings (not guaranteed by the Company)      |                              | 7,515    |
| Consolidated partner company term loans and other borrowings (guaranteed by the Company) |                              | 6,019    |
|  |                              | 32,034   |
| Capital lease obligations and other borrowings   |                              | 63       |
|  |                              | 32,097   |
| Less current maturities  |                              | (28,257) |
| Total long-term debt of discontinued operations, less current portion                    | \$                           | 3,840    |

In June 2008, the Company amended and restated its revolving credit facility that provides for borrowings and issuances of letters of credit and guarantees, reducing total availability from \$75.0 million to \$30.0 million. The amended and restated revolving credit facility expires on June 29, 2009. Borrowing availability under the facility is reduced by the amounts outstanding for the Company's borrowings and letters of credit and amounts guaranteed under Clariant's facility maintained with that same lender. This credit facility bears interest at the prime rate (5.0% at June 30, 2008) for outstanding borrowings. The credit facility is subject to an unused commitment fee of 0.125%,

which is subject to reduction based on deposits maintained at the bank. The credit facility requires the Company to maintain an unrestricted cash collateral account at that same bank, equal to the Company's borrowings and letters of credit and amounts borrowed by Clariant under its guaranteed facility maintained with that same bank. At June 30, 2008, the required cash collateral, pursuant to the Company's credit facility agreement, was \$18.6 million, which amount was included within Cash and cash equivalents on the Consolidated Balance Sheet as of June 30, 2008. Cash collateral requirements of \$21.3 million were eliminated upon closing of the Bundle Transaction.

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

Availability under the Company's revolving credit facility at June 30, 2008 was as follows:

|  | <b>Total<br/>(In<br/>thousands)</b> |
|--|-------------------------------------|
| Size of facility                             | \$ 30,000                           |
| Guaranty of Clariant's facility at same bank | (12,300)                            |
| Outstanding letter of credit (a)             | (6,336)                             |
| <br>   |                                     |
| Amount available                             | \$ 11,364                           |

(a) In connection with the sale of CompuCom Systems, Inc. (CompuCom) in 2004, the Company provided a letter of credit to the landlord of CompuCom's Dallas headquarters, which letter of credit will expire on March 19, 2019, in an amount equal to \$6.3 million.

Clariant maintains a \$12.0 million credit facility with the same lender as the Company. At Clariant's option, borrowings bear interest at variable rates based on the prime rate minus 0.5% or a rate equal to 30-day London Interbank Offered Rate (LIBOR) plus 2.45%, provided however, that upon the achievement of certain financial performance metrics, the rate will decrease by 0.25%. This facility contains financial and non-financial covenants and matures February 26, 2009.

Guarantees of partner company facilities by the Company of \$31.5 million were eliminated upon the closing of the Bundle Transaction.

In September 2006, Clariant entered into a \$5.0 million senior secured revolving credit agreement. Borrowing availability under the agreement was based on the level of Clariant's qualified accounts receivable, less certain reserves. The agreement bore interest at variable rates based on the lower of the 30-day LIBOR plus 3.25%, or the prime rate plus 0.5%. On March 17, 2008, Clariant borrowed \$4.6 million from the Company under the subordinated revolving credit line provided by the Company to Clariant to repay and terminate this facility, and borrowed an additional \$2.8 million from the Company to repay and terminate its equipment line of credit with the same lender.

On July 31, 2008, Clariant entered into an \$8.0 million secured credit facility with Gemino Healthcare Finance, LLC. Actual availability under the facility is limited by Clariant's qualified accounts receivable and certain liquidity factors. See Note 17.

Debt as of June 30, 2008 bore interest at a fixed rate of 13.1% and a variable rate of prime plus 0.5%, with a weighted average rate of 5.9%.

The Company's debt matures as follows:

|                     | <b>Total<br/>(In<br/>thousands)</b> |
|---------------------|-------------------------------------|
| Remainder of 2008   | \$ 107                              |
| 2009                | 9,234                               |
| 2010                | 248                                 |
| 2011                | 32                                  |
| 2012 and thereafter |                                     |
| <b>Total debt</b>   | <b>\$ 9,621</b>                     |

#### **8. CONVERTIBLE SENIOR DEBENTURES**

In February 2004, the Company completed the sale of \$150.0 million of 2.625% convertible senior debentures with a stated maturity of March 15, 2024 (the 2024 Debentures). Interest on the 2024 Debentures is payable semi-annually. At the

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

debenture holders option, the 2024 Debentures are convertible into the Company's common stock through March 14, 2024, subject to certain conditions. The conversion rate of the debentures is \$7.2174 of principal amount per share. The closing price of the Company's common stock at June 30, 2008 was \$1.24. The 2024 Debenture holders have the right to require the Company to repurchase the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their face amount, plus accrued and unpaid interest. The 2024 Debenture holders also have the right to require repurchase of the 2024 Debentures upon certain events, including sale of all or substantially all of our common stock or assets, liquidation, dissolution or a change in control. Subject to certain conditions, the Company may redeem all or some of the 2024 Debentures commencing March 20, 2009. During 2006, the Company repurchased \$21.0 million of face value of the 2024 Debentures for \$16.4 million in cash, including accrued interest. At June 30, 2008, the market value of the outstanding \$129.0 million 2024 Debentures was approximately \$96.6 million, based on quoted market prices.

As required by the terms of the 2024 Debentures, after completing the sale of CompuCom in October 2004, the Company escrowed \$16.7 million for interest payments through March 15, 2009 on the 2024 Debentures. A total of \$3.9 million is included in Restricted marketable securities on the Consolidated Balance Sheet at June 30, 2008, which is classified as a current asset.

**9. STOCK-BASED COMPENSATION**

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)) using the modified prospective method.

**Classification of Stock-Based Compensation Expense**

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

|                                   | <b>Three Months<br/>Ended June 30,</b> |                 | <b>Six Months Ended June<br/>30,</b> |                 |
|-----------------------------------|--|-----------------|--------------------------------------|-----------------|
|                                   | <b>2008</b>                            | <b>2007</b>     | <b>2008</b>                          | <b>2007</b>     |
|                                   | <b>(In thousands)<br/>(unaudited)</b>  |                 |                                      |                 |
| Cost of sales                     | \$ 9                                   | \$ 6            | \$ 21                                | \$ 18           |
| Selling, general & administrative | 846                                    | 1,312           | 1,631                                | 2,894           |
|                                   | <b>\$ 855</b>                          | <b>\$ 1,318</b> | <b>\$ 1,652</b>                      | <b>\$ 2,912</b> |

**The Company**

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. The Company issued 1.5 million market-based awards and 0.5 million service-based awards to employees during the three months ended June 30, 2008.

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

|                              | <b>Three Months</b>   |             | <b>Six Months Ended June</b> |             |
|------------------------------|-----------------------|-------------|------------------------------|-------------|
|                              | <b>Ended June 30,</b> |             | <b>30,</b>                   |             |
|                              | <b>2008</b>           | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
|                              | <b>(unaudited)</b>    |             |                              |             |
| <b>Service-Based Awards</b>  |                       |             |                              |             |
| Dividend yield               | 0%                    | 0%          | 0%                           | 0%          |
| Expected volatility          | 53%                   | 62%         | 53%                          | 62%         |
| Average expected option term | 5 years               | 5 years     | 5 years                      | 5 years     |
| Risk-free interest rate      | 3.4 %                 | 4.6%        | 3.4%                         | 4.6%        |
| <b>Market-Based Awards</b>   |                       |             |                              |             |
| Dividend yield               | 0%                    | 0%          | 0%                           | 0%          |
| Expected volatility          | 59%                   | 55%         | 59%                          | 56%         |
| Average expected option term | 6 years               | 6 years     | 6 years                      | 6 years     |
| Risk-free interest rate      | 3.6%                  | 4.9%        | 3.6%                         | 4.9%        |

Market-based awards entitle participants to vest in a number of options determined by achievement 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 three and six months ended June 30, 2008, 0 and 41 thousand options, respectively, vested based on achievement of market capitalization targets. The Company recorded a \$0.2 million benefit and \$0.0 million compensation expense related to these awards during the three and six months ended June 30, 2008. The benefit in the three months ended June 30, 2008 was due to the impact of forfeited awards. Depending on the Company's stock performance, the maximum number of unvested shares at June 30, 2008 attainable under these grants was 7.9 million 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. The Company recorded \$0.1 million and \$0.6 million of compensation expense related to these awards during the three months ended June 30, 2008 and 2007, respectively, and \$0.4 million and \$1.0 million during the six months ended June 30, 2008 and 2007, respectively. The decrease in 2008 was due to the impact of forfeited awards.

**Majority-Owned Partner Companies**

Stock options granted by majority-owned partner companies generally are service-based awards that vest over four years after the date of grant and expire seven to 10 years after the date of grant. Compensation expense is recognized over the requisite service period using the straight-line method. The requisite service period is the period over which the award vests. The fair value of the Company's majority-owned partner companies' stock-based awards to employees were 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 for Clariant, the Company's publicly-held consolidated partner company, was based on historical price volatility measured using weekly price observations of Clariant's common stock for a period equal to the stock option's expected term. Expected volatility for the Company's former majority-owned and privately-held partner companies—Acsis, Alliance Consulting and Laureate Pharma, which stock-based compensation was not included in continuing operations due to the Bundle Transaction that closed on May 6, 2008 (see Note 3), was based on the average historical volatility of comparable companies for a period equal to the stock option's expected term. The fair value of the underlying stock of Acsis,

Alliance Consulting and Laureate Pharma on the date of grant was determined based on a number of valuation methods, including discounted cash flows and public company and acquisition multiples for comparable companies.

During the six months ended June 30, 2008, Clariant granted 2.1 million options and 0.2 million on restricted stock awards. The restricted stock awards vest over four years. The options generally have four-year vesting terms and a ten-year contractual term. The fair value of these options at the date of grant was based on the following assumptions: a risk-free rate of 2.5% - 3.4%, an expected stock option term of five years, a dividend yield of 0.0% and expected five year volatility of 78% - 88%. Clariant estimates forfeitures of stock options using historical



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**SAFEGUARD SCIENTIFICS, INC.**  
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exercise behavior of its employees. For purposes of this estimate, Clariant identified two groups of employees and estimated the forfeiture rates for these groups to be 5% and 8% for the first and second quarter of 2008. Clariant recorded \$0.9 million and \$0.2 million of stock-based compensation expense during the three months ended June 30, 2008 and 2007, respectively, and \$1.2 million and \$0.8 million during the six months ended June 30, 2008 and 2007, respectively.

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**SAFEGUARD SCIENTIFICS, INC.**  
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**JUNE 30, 2008**

**10. INCOME TAXES**

The Company's consolidated income tax (expense) benefit was \$(4) thousand and \$710 thousand for the three months ended June 30, 2008 and 2007, respectively, and \$(4) thousand and \$696 thousand for the six months ended June 30, 2008 and 2007, respectively. The net income tax benefit recognized in the three and six months ended June 30, 2007 resulted from the reversal of reserves that related to uncertain tax positions for which the statute of limitations expired during the period in the applicable tax jurisdictions and the Company's share of net state tax expense recorded by its partner companies. The Company has recorded a valuation allowance to reduce its net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the benefit of the net operating loss that would have been recognized in 2008 and 2007 was offset by a valuation allowance.

On January 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109 (FIN 48). During the first half of 2008, the Company had no material changes in uncertain tax positions.

**11. NET LOSS PER SHARE**

The calculations of net loss per share were:

|                                       | <b>Three Months Ended</b>                   |             | <b>Six Months Ended June</b> |             |
|---------------------------------------|---|-------------|------------------------------|-------------|
|                                       | <b>June 30,</b>                             |             | <b>30,</b>                   |             |
|                                       | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
|                                       | <b>(In thousands except per share data)</b> |             |                              |             |
|                                       | <b>(unaudited)</b>                          |             |                              |             |
| Basic and diluted:                    |   |             |                              |             |
| Net loss from continuing operations   | \$ (7,407)                                  | \$ (9,609)  | \$ (18,858)                  | \$ (18,484) |
| Net loss from discontinued operations | (1,024)                                     | (4,232)     | (8,100)                      | (7,039)     |
| Net loss                              | \$ (8,431)                                  | \$ (13,841) | \$ (26,958)                  | \$ (25,523) |
| <br>                                  |   |             |                              |             |
| Average common shares outstanding     | 123,111                                     | 122,338     | 123,054                      | 122,227     |
| <br>                                  |   |             |                              |             |
| Net loss from continuing operations   | \$ (0.06)                                   | \$ (0.08)   | \$ (0.15)                    | \$ (0.15)   |
| Net loss from discontinued operations | (0.01)                                      | (0.03)      | (0.07)                       | (0.06)      |
| Net loss per share                    | \$ (0.07)                                   | \$ (0.11)   | \$ (0.22)                    | \$ (0.21)   |

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

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

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

§ At June 30, 2008 and 2007 options to purchase 20.1 million and 20.6 million shares of common stock, respectively, at prices ranging from \$1.03 to \$30.47 per share, were excluded from the calculations.

- § At June 30, 2008 and 2007, unvested restricted stock units and DSUs convertible into 0.1 million shares were excluded from the calculations.
- § At June 30, 2008 and 2007, a total of 17.9 million shares related to the Company's 2024 Debentures (see Note 8) representing the weighted average effect of assumed conversion of the 2024 Debentures were excluded from the calculations.

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**SAFEGUARD SCIENTIFICS, INC.**  
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**12. PARENT COMPANY FINANCIAL INFORMATION**

Parent company financial information is provided to present the financial position and results of operations of the Company as if its consolidated partner company, Clariant, (see Note 2) was accounted for under the equity method of accounting for all periods presented during which the Company owned its interest in Clariant.

**Parent Company Balance Sheets**

|  | <b>June 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|--|--------------------------|------------------------------|
|  | <b>(In thousands)</b>    |                              |
|  | <b>(unaudited)</b>       |                              |
| Assets:  |                          |                              |
| Cash and cash equivalents                        | \$ 150,533               | \$ 94,685                    |
| Cash held in escrow - current                    | 6,407                    | 20,345                       |
| Marketable securities                            | 2,191                    | 590                          |
| Restricted marketable securities                 | 3,933                    | 3,904                        |
| Other current assets                             | 2,242                    | 691                          |
| Assets held for sale                             |                          | 77,704                       |
| <br>   |                          |                              |
| Total current assets                             | 165,306                  | 197,919                      |
| Ownership interests in and advances to companies | 106,341                  | 99,455                       |
| Long-term restricted marketable securities       |                          | 1,949                        |
| Cash held in escrow - long-term                  | 2,352                    | 2,341                        |
| Other  | 2,176                    | 2,565                        |
| <br>   |                          |                              |
| Total Assets                                     | \$ 276,175               | \$ 304,229                   |
| <br>   |                          |                              |
| Liabilities and Shareholders' Equity:            |                          |                              |
| Current liabilities                              | \$ 12,128                | \$ 15,494                    |
| Long-term liabilities                            | 5,343                    | 5,012                        |
| Convertible senior debentures                    | 129,000                  | 129,000                      |
| Shareholders' equity                             | 129,704                  | 154,723                      |
| <br>   |                          |                              |
| Total Liabilities and Shareholders' Equity       | \$ 276,175               | \$ 304,229                   |

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
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**Parent Company Statements of Operations**

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended June</b> |             |
|---|---------------------------|-------------|------------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>30,</b>                   |             |
|   | <b>2008</b>               | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
|   | <b>(In thousands)</b>     |             |                              |             |
|   | <b>(unaudited)</b>        |             |                              |             |
| Operating expenses                                      | \$ (4,117)                | \$ (5,465)  | \$ (9,414)                   | \$ (11,739) |
| Other income (loss), net                                | 2,263                     | (744)       | 2,623                        | (689)       |
| Recovery related party                                  | 3                         |             | 4                            |             |
| Interest income   | 782                       | 2,142       | 1,707                        | 4,260       |
| Interest expense  | (1,052)                   | (1,053)     | (2,107)                      | (2,110)     |
| Equity loss   | (5,286)                   | (5,199)     | (11,671)                     | (8,916)     |
| Net loss from continuing operations before income taxes | (7,407)                   | (10,319)    | (18,858)                     | (19,194)    |
| Income tax benefit                                      |                           | 710         |                              | 710         |
| Equity loss attributable to discontinued operations     | (1,024)                   | (4,232)     | (8,100)                      | (7,039)     |
| Net loss  | \$ (8,431)                | \$ (13,841) | \$ (26,958)                  | \$ (25,523) |

**Parent Company Statements of Cash Flows**

|                                       | <b>Six Months Ended June 30,</b> |             |
|---------------------------------------|----------------------------------|-------------|
|                                       | <b>2008</b>                      | <b>2007</b> |
|                                       | <b>(In thousands)</b>            |             |
|                                       | <b>(unaudited)</b>               |             |
| Net cash used in operating activities | \$ (8,553)                       | \$ (9,350)  |

**Cash Flows from Investing Activities:**

|  |          |           |
|--|----------|-----------|
| Proceeds from sales of and distributions from companies and funds                        | 3,496    | 2,304     |
| Advances to companies  | (13,941) | (191)     |
| Acquisitions of ownership interests in partner companies and funds, net of cash acquired | (7,168)  | (41,309)  |
| Repayments of note receivable related party  | 4        |           |
| Increase in marketable securities  | (3,455)  | (126,176) |
| Decrease in marketable securities  | 1,854    | 166,523   |
| Capital expenditures   | (28)     |           |
| Proceeds from sale of discontinued operations  | 83,798   | 19,655    |
| Net cash provided by investing activities  | 64,560   | 20,806    |

**Cash Flows from Financing Activities:**

|                                       |    |     |
|---------------------------------------|----|-----|
| Issuance of Company common stock, net | 64 | 539 |
|---------------------------------------|----|-----|

|   |            |           |
|---|------------|-----------|
| Repurchase of Company common stock                  | (223)      |           |
| Net cash (used in) provided by financing activities | (159)      | 539       |
| Net Increase in Cash and Cash Equivalents           | 55,848     | 11,995    |
| Cash and Cash Equivalents at beginning of period    | 94,685     | 59,933    |
| Cash and Cash Equivalents at end of period          | \$ 150,533 | \$ 71,928 |

Parent Company cash and cash equivalents excludes marketable securities, which consist of longer-term securities, including commercial paper and certificates of deposit.

### 13. OPERATING SEGMENTS

As of June 30, 2008 the Company held an interest in one majority-owned partner company, Clariant, and 13 minority-owned partner companies. During the first quarter of 2008, the Company re-evaluated its reportable operating segments in accordance with SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information. As a result of the re-evaluation, the Company's reportable operating segments are now as follows: i) Clariant, its publicly-traded consolidated partner company, ii) Life Sciences and iii) Technology.

The Life Sciences segment includes the following partner companies as of June 30, 2008: Advanced BioHealing, Inc., Alverix, Inc., Avid Radiopharmaceuticals, Inc., Cellumen, Inc., NuPathe, Inc. and Rubicor Medical, Inc.

The Technology segment includes the following partner companies as of June 30, 2008: Advantedge Healthcare Solutions, Inc., Authentium, Inc., Beyond.com, Inc., Bridgevine, Inc., NextPoint Networks, Inc., Portico Systems, Inc. and a yet-to-be publicly launched web-based software company (Stealth Company).

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

Results of the Life Sciences and Technology segments reflect the equity income (loss) of their respective equity method partner companies, other income (loss) associated with cost method partner companies and the gains or losses on the sale of their respective partner companies.

The Company's reportable operating segments for the year ended December 31, 2007 were: i) Acsis, ii) Alliance Consulting, iii) Clariant, iv) Laureate Pharma and v) Other Companies. Acsis, Alliance Consulting and Laureate Pharma were majority-owned partner companies reported within discontinued operations due to the Bundle Transaction. The Other Companies segment consisted of the operations of non-consolidated partner companies (currently separate segments - Life Sciences and Technology) and the Company's ownership in private equity funds (currently included within Other Items). The Other Companies segment also included the gain or loss on the sale of companies (currently included within the respective Life Sciences and Technology segments) and private equity funds (currently included within Other Items), except for gains and losses included in discontinued operations.

Management evaluates its Clariant segment performance based on revenue, operating income (loss) and income (loss) before income taxes, which reflects the portion of income (loss) allocated to minority shareholders. Management evaluates its Life Sciences and Technology segments' performance based on equity income (loss) which is based on the number of respective partner companies accounted for under the equity method, the Company's voting ownership percentage in these partner companies and the net results of operations of these partner companies.

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.

The following tables reflect the Company's consolidated operating data by reportable segment. Segment results include the results of Clariant, its consolidated partner company, impairment charges, gains or losses related to the disposition of partner companies (except those reported in discontinued operations) the Company's share of income or losses for entities accounted for under the equity method and the mark-to-market of trading securities. All significant intersegment activity has been eliminated in consolidation. Accordingly, segment results reported by the Company exclude the effect of transactions between the Company and its consolidated partner company.

Revenue is attributed to geographic areas based on where the services are performed or the customer's shipped to location. A majority of the Company's revenue is generated in the United States.

As of June 30, 2008 and December 31, 2007, the Company's assets were primarily located in the United States.

The following represents segment data from continuing operations:

**Three Months Ended June 30, 2008**  
**(In thousands)**  
**(unaudited)**

|                       | Clariant | Life Sciences | Technology | Total Segments | Other Items | Total Continuing Operations |
|-----------------------|----------|---------------|------------|----------------|-------------|-----------------------------|
| Revenue               | \$16,916 | \$            | \$         | \$ 16,916      | \$          | \$ 16,916                   |
| Operating loss        | (1,743)  |               |            | (1,743)        | (4,117)     | (5,860)                     |
| Net loss              | (105)    | (3,563)       | (1,664)    | (5,332)        | (2,075)     | (7,407)                     |
| <b>Segment Assets</b> |          |               |            |                |             |                             |
| June 30, 2008         | \$42,447 | \$32,435      | \$ 46,337  | \$121,219      | \$178,179   | \$ 299,398                  |
| December 31, 2007     | 39,502   | 40,829        | 43,797     | 124,128        | 135,447     | 259,575                     |





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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

**Three Months Ended June 30, 2007**  
**(In thousands)**  
**(unaudited)**

|                | Clariant | Life Sciences | Technology | Total Segments | Other Items | Total Continuing Operations |
|----------------|----------|---------------|------------|----------------|-------------|-----------------------------|
| Revenue        | \$ 9,873 | \$            | \$         | \$ 9,873       | \$          | \$ 9,873                    |
| Operating loss | (2,772)  |               |            | (2,772)        | (5,465)     | (8,237)                     |
| Net loss       | (1,749)  | (2,944)       | (1,255)    | (5,948)        | (3,661)     | (9,609)                     |

**Six Months Ended June 30, 2008**  
**(In thousands)**  
**(unaudited)**

|                | Clariant | Life Sciences | Technology | Total Segments | Other Items | Total Continuing Operations |
|----------------|----------|---------------|------------|----------------|-------------|-----------------------------|
| Revenue        | \$32,802 | \$            | \$         | \$ 32,802      | \$          | \$ 32,802                   |
| Operating loss | (1,913)  |               |            | (1,913)        | (9,414)     | (11,327)                    |
| Net loss       | (203)    | (7,949)       | (3,451)    | (11,603)       | (7,255)     | (18,858)                    |

**Six Months Ended June 30, 2007**  
**(In thousands)**  
**(unaudited)**

|                | Clariant | Life Sciences | Technology | Total Segments | Other Items | Total Continuing Operations |
|----------------|----------|---------------|------------|----------------|-------------|-----------------------------|
| Revenue        | \$18,702 | \$            | \$         | \$ 18,702      | \$          | \$ 18,702                   |
| Operating loss | (6,066)  |               |            | (6,066)        | (11,739)    | (17,805)                    |
| Net loss       | (3,723)  | (4,120)       | (1,841)    | (9,684)        | (8,800)     | (18,484)                    |

**Other Items**

|                              | <b>Three Months Ended June 30,</b>          |             | <b>Six Months Ended June 30,</b> |             |
|------------------------------|---|-------------|----------------------------------|-------------|
|                              | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                      | <b>2007</b> |
|                              | <b>(In thousands)</b><br><b>(unaudited)</b> |             |                                  |             |
| Corporate operations         | \$ (2,071)                                  | \$ (4,371)  | \$ (7,251)                       | \$ (9,496)  |
| Income tax (expense) benefit | (4)   | 710         | (4)                              | 696         |
|                              | \$ (2,075)                                  | \$ (3,661)  | \$ (7,255)                       | \$ (8,800)  |

**14. BUSINESS COMBINATIONS****Acquisitions by the Company 2008**

In May 2008, the Company increased its ownership interest in Advantedge Healthcare Solutions ( AHS ) from 35.1% to 37.9% for \$3.2 million in cash. AHS is a New Jersey-based technology-enabled service provider that

delivers medical billing services to physician groups. The Company accounts for its holdings in AHS under the equity method.

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

In April 2008, the Company increased its ownership interest in NuPathe, Inc. ( NuPathe ) from 26.2% to 27.8% for \$1.0 million in cash. The Company previously deployed \$5.0 million in NuPathe in 2007 and 2006. NuPathe develops therapeutics in conjunction with novel delivery technologies. The Company accounts for its holdings in NuPathe under the equity method.

In February 2008, the Company deployed \$2.8 million of cash in Portico Systems, Inc ( Portico ), maintaining a 46.8% ownership interest. The Company previously had acquired an interest in Portico in August 2006 for \$6.0 million in cash. Portico is a software solutions provider for regional and national health plans looking to optimize provider network operations and streamline business processes. The Company accounts for its holdings in Portico under the equity method.

***Acquisitions by the Company 2007***

In September 2007, the Company funded NexTone Communications, Inc. ( NexTone ) \$2.2 million in cash. In December 2007, the Company funded NexTone an additional \$2.1 million in cash, which was held in an escrow account until January 2008, at which time NexTone, Inc. merged with Reef Point Systems, Inc. to form NextPoint Networks, Inc. The January 2008 merger and related financing resulted in the Company holding 12.2% of NextPoint Networks. The Company accounts for its holdings in NextPoint Networks under the cost method.

In October 2007, the Company acquired 50.0% of Alverix, Inc. ( Alverix ) for \$2.4 million in cash. Alverix has developed a next-generation platform for quantifying and analyzing assays in the point-of-care diagnostics market. The technology utilizes optical sensors, image processing software and signal enhancement algorithms to achieve more accurate measurements in an inexpensive, miniaturized meter. The Company accounts for its holdings in Alverix under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Alverix was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests and advances to companies on the Consolidated Balance Sheets. The Company has committed to fund Alverix an additional \$1.5 million, conditional upon the achievement of certain milestones.

In October 2007, the Company increased its ownership interest in NuPathe from 21.3% to 26.2% for \$2.0 million in cash. The Company previously had acquired an interest in NuPathe in September 2006 for \$3.0 million in cash. NuPathe develops therapeutics in conjunction with novel delivery technologies. The Company accounts for its holdings in NuPathe under the equity method. The difference between the Company's cost and its interest in the underlying net assets of NuPathe has been allocated to in-process research and development, resulting in charges of \$0.2 million and \$1.0 million in 2007 and 2006, respectively, which are reflected in Equity loss in the Consolidated Statement of Operations and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheets.

In August 2007, the Company acquired 21.1% of Bridgevine, Inc. ( Bridgevine ), formerly known as Broadband National, Inc., for \$8.0 million in cash. Bridgevine is an internet media company that operates a network of shopping websites focused on digital services and products such as high speed internet, digital phone, VoIP, TV and music. The Company accounts for its holdings in Bridgevine under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Bridgevine was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheets.

In August 2007, the Company acquired 14.0% of a Stealth Company for \$2.2 million in cash, which acquisition is accounted for under the cost method.

In June 2007, the Company acquired 40.3% of Cellumen, Inc. ( Cellumen ) for \$6.0 million in cash. Cellumen is a cellular systems biology company whose technology optimizes the drug discovery process. The Company accounts for its holdings in Cellumen under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Cellumen was allocated to in-process research and development, resulting in a \$0.2 million charge in the second quarter of 2007, and to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheets.

In June 2007, the Company increased its ownership interest in Authentium, Inc. ( Authentium ) to 19.9%, for an additional \$3.0 million in cash. The Company previously had acquired a 12.4% interest in Authentium in April 2006 for \$5.5

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

million in cash. Authentium is a provider of security software to internet service providers. The Company accounts for its holdings in Authentium under the cost method.

In May 2007, the Company acquired 14.2% of Avid Radiopharmaceuticals, Inc. ( Avid ) for \$7.3 million in cash. Avid develops molecular imaging products for neurodegenerative diseases and diabetes. The Company accounts for its holdings in Avid under the cost method.

In May 2007, the Company increased its ownership interest in Advanced BioHealing, Inc. ( ABH ) to 28.3% for \$2.8 million in cash. The Company previously had acquired a 23.9% interest in ABH in February 2007 for \$8.0 million in cash. ABH is a specialty biotechnology company focused on the development and marketing of cell-based and tissue engineered products. The Company accounts for its holdings in ABH under the equity method. The difference between the Company's cost and its interest in the underlying net assets of ABH was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheets.

In March 2007, the Company acquired 37.1% of Beyond.com, Inc. ( Beyond.com ) for \$13.5 million in cash. Beyond.com is a provider of online technology and career services to job seekers and corporations. The Company accounts for its holdings in Beyond.com under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Beyond.com was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheets.

**15. COMMITMENTS AND CONTINGENCIES**

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

The Company had the following outstanding guarantees at June 30, 2008:

|                          | <b>Amount</b>    | <b>Debt Included<br/>on<br/>Consolidated<br/>Balance Sheet<br/>(In thousands)<br/>(unaudited)</b> |
|--------------------------|------------------|---|
| Clariant credit facility | \$ 12,300        | \$ 9,000  |
| Other guarantees         | 3,750            |   |
| <b>Total</b>             | <b>\$ 16,050</b> | <b>\$ 9,000</b>   |

The Company has committed capital of approximately \$3.1 million, including conditional commitments to provide non-consolidated partner companies with additional funding and commitments made to various private equity funds in prior years. These commitments will be funded over the next several years, including approximately \$2.4 million which is expected to be funded during the next 12 months.

Under certain circumstances, the Company may be required to return a portion or all the distributions it received as a general partner of certain private equity funds (the clawback ). Assuming the private equity funds in which the Company was a general partner were liquidated or dissolved on June 30, 2008 and assuming for these purposes the only distributions from the funds were equal to the carrying value of the funds on the June 30, 2008 financial statements, the maximum clawback the Company would be required to return due to our general partner interest is approximately \$6.9 million. The Company estimates its liability to be approximately \$6.5 million, of which

\$4.1 million was reflected in Accrued expenses and other current liabilities and \$2.4 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet at June 30, 2008. The Company paid \$3.0 million of its estimated clawback liabilities in July 2008.

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

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 in escrow and adding rights of set-off among certain funds. The Company believes its liability due to the default of other general partners is remote.

Notwithstanding the closing of the Bundle Transaction, the Company remains a guarantor of Laureate Pharma's Princeton, New Jersey office facility lease through its expiration in 2016. However, the Company is entitled to indemnification and certain payments in connection with the continuation of such guaranty. As of June 30, 2008, scheduled lease payments to be made by Laureate Pharma over the remaining lease term equal \$9.7 million.

In anticipation of the sale of Pacific Title & Art Studio in the first quarter of 2007, the Company permitted the employment agreement of the Pacific Title & Art Studio CEO to expire without renewal, and thereby his employment ceased. Following the sale, the former CEO demanded payment of severance benefits under his employment agreement, as well as payment of his deferred stock units and other amounts substantially in excess of the maximum amounts the Company believed were arguably due. The former CEO and the Company thereafter engaged in negotiations, but were ultimately unable to settle on the appropriate amounts due. On or about August 13, 2007, the former CEO filed a complaint in the Superior Court of the State of California, County of Los Angeles, Central District, against the Company and Pacific Title & Art Studio, alleging, among other things: wrongful termination, conversion, unfair competition, violation of the labor code, breach of contract and negligence. On or about March 28, 2008, Plaintiff amended his complaint to add as a defendant the party which purchased Pacific Title & Art Studio from the Company and to add several further causes of action. In his amended complaint, the former CEO made claims for compensatory damages in excess of \$24.6 million, plus exemplary and punitive damages and interest. The Company has engaged counsel to represent the Company and Pacific Title & Art Studio in this matter and has also put the Company's insurance carriers on notice of the claims. The Company has denied the relief sought and has filed a cross complaint alleging breach of fiduciary duty and breach of contract. On April 23, 2008, the Company made a payment to the former CEO in the amount of approximately \$2.4 million, net of applicable withholdings, representing amounts the Company believes were owed to the plaintiff under his employment agreement and deferred stock units. The case continues to proceed through the discovery/pre-trial phase.

In October 2001, the Company entered into an agreement with Mr. Musser, its former Chairman and Chief Executive Officer, to provide for annual payments of \$0.7 million per year and certain health care and other benefits for life. The related current liability of \$0.8 million was included in Accrued expenses and the long-term portion of \$1.7 million was included in Other long-term liabilities on the Consolidated Balance Sheet at June 30, 2008.

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 \$8.0 million at June 30, 2008.

#### **16. CORRECTION OF AN IMMATERIAL ERROR IN PRIOR PERIODS**

During the fourth quarter of 2007, an accounting error at Clariant was identified. The error related to Clariant's accounting for customer refunds which affected the Company's previously reported quarterly results in 2007 and 2006, totaling \$0.8 million.

In accordance with Staff Accounting Bulletin No. 108, the Company's management evaluated the materiality of the error from qualitative and quantitative perspectives, and evaluated the quantified error under both the iron curtain and the roll-over methods. Management concluded that the error was immaterial to prior periods, but to remain consistent with revisions made to Clariant's June 30, 2008 Form 10-Q, the Company made such revisions to its Consolidated Financial Statements contained herein, as summarized below.

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**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**JUNE 30, 2008**

The following table summarizes the effect of the revision on continuing operations for the quarter and six months ended June 30, 2007:

|   | <b>Quarter Ended</b>  |                | <b>Six Months Ended</b> |                |
|---|-----------------------|----------------|-------------------------|----------------|
|   | <b>June 30, 2007</b>  |                | <b>June 30, 2007</b>    |                |
|   | <b>(In thousands)</b> |                | <b>(In thousands)</b>   |                |
|   | <b>Previously</b>     | <b>As</b>      | <b>Previously</b>       | <b>As</b>      |
|   | <b>Reported (1)</b>   | <b>Revised</b> | <b>Reported (1)</b>     | <b>Revised</b> |
| <b>Statement of Operations:</b>                             |                       |                |                         |                |
| Revenue   | \$ 10,336             | \$ 9,873       | \$ 19,193               | \$ 18,702      |
| Operating loss  | (7,774)               | (8,237)        | (17,314)                | (17,805)       |
| Minority interest   | 1,492                 | 1,304          | 3,153                   | 2,954          |
| Net loss from continuing operations before income taxes     | (10,044)              | (10,319)       | (18,889)                | (19,180)       |
| Net loss from continuing operations                         | (9,334)               | (9,609)        | (18,193)                | (18,484)       |
| Basic and diluted loss per share from continuing operations | \$ (0.08)             | \$ (0.08)      | \$ (0.15)               | \$ (0.15)      |

(1) Restated for discontinued operations. See Note 3.

**17. SUBSEQUENT EVENTS**

On July 31, 2008, Clariant entered into a secured credit agreement (the Gemino Facility) with Gemino Healthcare Finance, LLC (Gemino). The Gemino Facility is a revolving facility under which Clariant may borrow up to \$8.0 million which is secured by Clariant's accounts receivable and related assets. The amount which Clariant is entitled to borrow under the Gemino Facility at a particular time (approximately \$5.0 million as of July 31, 2008) is based on the amount of Clariant's qualified accounts receivable and certain liquidity factors. Borrowings under the Gemino Facility, which may be repaid and re-borrowed, bear interest at a rate per annum equal to 30-day LIBOR (subject to a minimum annual rate of 2.50% at all times) plus an applicable margin of 5.25%. If Clariant meets certain financial benchmarks for its 2008 fiscal year, the applicable margin may be reduced to 4.75%. Clariant pays an unused commitment fee of 0.75%, and the facility is subject to a prepayment fee of \$0.2 million. The Gemino Facility's current maturity date is January 31, 2009. The maturity date may be extended for two additional 12-month periods upon the satisfaction of certain conditions. Clariant repaid the Company \$4.9 million of indebtedness under the Mezzanine Facility with proceeds borrowed under the Gemino Facility. The Company has entered into a subordination agreement with Gemino relating to the Gemino Facility.

On July 23, 2008, the Company held its 2008 annual meeting of shareholders, during which the Company's shareholders voted to authorize a reverse split of the Company's common stock at an exchange ratio of not less than 1-for-4 and not more than 1-for-8, at the discretion of the Company's Board of Director. The Board of Directors may effect the reverse stock split at any time prior to the Company's 2009 annual meeting of shareholders or may choose not to implement the reverse stock split at all.



**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 convey uncertainty of future events or outcomes, we are making forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Our forward-looking statements are subject to risks and uncertainties. Factors that could cause actual results to differ materially, include, among others, 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 growth-stage technology and life sciences businesses. We provide capital as well as a range of strategic, operational and management resources to our partner companies. Safeguard participates in expansion financings, corporate spin-outs, management buy-outs, recapitalizations, industry consolidations and early-stage financings. Our vision is to be the preferred catalyst for creating great technology and life sciences companies.

We strive to create long-term value for our shareholders by building value in our partner companies. We help our partner companies to increase market penetration, grow revenue and improve cash flow in order to create long-term value. We concentrate on companies that operate in two categories:

*Technology* including companies focused on providing software as a service (SaaS), technology-enabled services and vertical software solutions for the financial services sector, internet-based businesses and healthcare information technology; and

*Life Sciences* including companies focused on molecular and point-of-care diagnostics, medical devices and specialty pharmaceuticals.

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

We account for our interests in our partner companies and private equity funds using three methods: consolidation, equity or cost. 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 our partner companies in which we directly or indirectly own more than 50% of the outstanding voting securities using the consolidation method of accounting. We reflect the participation of other partner company stockholders in the income or losses of our consolidated partner companies as Minority Interest in the Consolidated Statements of Operations. Minority interest adjusts our consolidated operating results to reflect only our share of the earnings or losses of the consolidated partner companies. If there is no minority interest balance remaining on the Consolidated Balance Sheets related to the respective partner company, we record 100% of the consolidated partner company's losses; we record 100% of subsequent earnings of the partner company to the extent of

such previously recognized losses in excess of our proportionate share.

*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

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under the equity method of accounting, depending on our respective 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 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.

When the carrying value of our holding 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 using 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. However, the effect of the change in market value of cost method partner company holdings classified as trading securities is reflected in Other income (loss), net in the Consolidated Statements of Operations.

**Critical Accounting Policies and Estimates**

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

- § Revenue recognition;
- § Impairment of long-lived assets;
- § Goodwill impairment;
- § Impairment of ownership interests in and advances to companies;
- § Income taxes;
- § Commitments and contingencies; and
- § Stock-based compensation.

***Revenue Recognition***

During the first three and six months of 2008 and 2007, our revenue from continuing operations was attributable to Clariant.

Clariant generates revenue from diagnostic services and recognizes such revenue at the time of completion of services at amounts equal to the contractual rates allowed from third parties including Medicare, insurance companies and, to a small degree, private-pay patients. These expected amounts are based both on Medicare allowable rates and Clariant's collection experience with other third-party payors.

***Impairment of Long-Lived Assets***

We test long-lived assets, including property and equipment and amortizable intangible assets, for recoverability whenever events or changes in circumstances indicate that we may not be able to recover the asset's carrying amount. We evaluate the recoverability of an asset by comparing its carrying amount to the undiscounted cash flows expected to result from the use and eventual disposition of that asset. If the undiscounted cash flows are not sufficient to recover the carrying amount, we measure any impairment loss as the excess of the carrying amount of the asset over its fair value.

The carrying value of net property and equipment at June 30, 2008 was \$12.2 million.

**Table of Contents*****Impairment of Goodwill***

We conduct an annual review for impairment of goodwill as of December 1st and as otherwise required by circumstances or events. Additionally, on an interim basis, we assess the impairment of goodwill whenever events or changes in circumstances would more likely than not reduce the fair value of a reporting unit below its carrying amount. Factors that we consider important which could trigger an impairment review include significant underperformance relative to historical or expected future operating results, significant changes in the manner or use of the acquired assets or the strategy for the overall business, significant negative industry or economic trends or a decline in a company's stock price for a sustained period.

We test for impairment at a reporting unit level (which for us is the same as an operating segment as defined in SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*). If we determine that the fair value of a reporting unit is less than its carrying value, we assess whether goodwill of the reporting unit is impaired. To determine fair value, we use a number of valuation methods including quoted market prices, discounted cash flows and public company and acquisition multiples for comparable companies. Depending on the complexity of the valuation and the significance of the carrying value of the goodwill to the Consolidated Financial Statements, we may engage an outside valuation firm to assist us in determining fair value. As an overall check on the reasonableness of the fair values attributed to our reporting units, we will consider comparing the aggregate fair values for all reporting units with our average total market capitalization for a reasonable period of time.

The carrying value of goodwill at June 30, 2008 was \$12.7 million.

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 goodwill 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 value of our goodwill is not impaired, there can be no assurance that a significant write-down or write-off will not be required in the future.

***Impairment of Ownership Interests In and Advances to Companies***

On a periodic basis (but no less frequently than at the end of each quarter) we evaluate the carrying value of our equity and cost method partner companies for possible impairment based on achievement of business plan objectives and milestones, the financial condition and prospects of the company 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 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, valuation of comparable public companies and the valuation of acquisitions of similar 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 new carrying value of a partner company is not increased if circumstances suggest the value of the partner company has subsequently recovered.

Our partner companies generally 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 companies could change in the near term and that the effect of such changes on our Consolidated Financial Statements could be material. While we believe that the current recorded carrying values of our equity and cost method companies are not impaired, there can be no assurance that our future results will confirm this assessment or that a significant write-down or write-off will not be required in the future.

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In the first quarter of 2008 we recognized an impairment loss of \$3.6 million, which is included within Loss from discontinued operations in the Consolidated Statements of Operations for the six months ended June 30, 2008. See Discontinued Operations below.

***Income Taxes***

We are required to estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our Consolidated Balance Sheets. We must assess the likelihood that the deferred tax assets will be recovered from future taxable income and to the extent that we believe recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance in a period, we must include an expense within the tax provision in the Consolidated Statements of Operations. We have recorded a valuation allowance to reduce our deferred tax assets to an amount that is more likely than not to be realized in future years. If we determine in the future that it is more likely than not that the net deferred tax assets would be realized, then the previously provided valuation allowance would be reversed.

***Commitments and Contingencies***

From time to time, we are a defendant or plaintiff in various legal actions which arise in the normal course of business. Additionally, we have received distributions as both a general partner and a limited partner from certain 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 (the 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. 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***

On January 1, 2006, we adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)). SFAS No. 123(R) requires companies to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. We adopted SFAS No. 123(R) using the modified prospective method. Accordingly, we have not restated prior period amounts. Under this application, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

We estimate the grant date fair value of stock options using the Black-Scholes option-pricing model which requires the input of highly subjective 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. In addition, 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.

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

On May 6, 2008 the Company consummated the Bundle Transaction pursuant to which it sold all of its equity and debt interests in Acsis, Alliance Consulting, Laureate Pharma, ProModel and Neuronix.

We present Clariant, our publicly traded consolidated partner company, as a separate segment. The results of operations of our other partner companies in which we have less than a majority interest are reported in our Life Sciences and Technology segments. The Life Sciences and Technology segments also include the gain or loss on the sale of respective partner companies, except for gains and losses included in discontinued operations.

Our management evaluates our Clariant segment performance based on revenue, operating income (loss) and income (loss) before income taxes, which reflects the portion of income (loss) allocated to minority shareholders. Our management evaluates our Life Sciences and Technology segments performance based on their equity income (loss) which is based on the number of respective partner companies accounted for under the equity method, the Company's voting ownership percentage in these partner companies and the net results of operations of these partner companies and Other income or loss associated with cost method partner companies.

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 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 the results of Clariant, our consolidated partner company and our share of income or losses for entities accounted for under the equity method when applicable. Segment results also include impairment charges, gains or losses related to the disposition of partner companies, except for those reported in discontinued operations and the mark-to-market of trading securities. All significant inter-segment activity has been eliminated in consolidation. Accordingly, segment results reported by us exclude the effect of transactions between us and our consolidated partner company.

Our operating results including net income (loss) before income taxes by segment were as follows:

|   | <b>Three Months Ended June</b> |             | <b>Six Months Ended June</b> |             |
|---|--------------------------------|-------------|------------------------------|-------------|
|   | <b>30,</b>                     |             | <b>30,</b>                   |             |
|   | <b>2008</b>                    | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
|   | <b>(In thousands)</b>          |             | <b>(In thousands)</b>        |             |
|   | <b>(unaudited)</b>             |             | <b>(unaudited)</b>           |             |
| Clariant                                      | \$ (105)                       | \$ (1,749)  | \$ (203)                     | \$ (3,723)  |
| Life Sciences                                 | (3,563)                        | (2,944)     | (7,949)                      | (4,120)     |
| Technology                                    | (1,664)                        | (1,255)     | (3,451)                      | (1,841)     |
| Total segments                                | (5,332)                        | (5,948)     | (11,603)                     | (9,684)     |
| Other items:                                  |                                |             |                              |             |
| Corporate operations                          | (2,071)                        | (4,371)     | (7,251)                      | (9,496)     |
| Income tax expense                            | (4)                            | 710         | (4)                          | 696         |
| Total other items                             | (2,075)                        | (3,661)     | (7,255)                      | (8,800)     |
| Net loss from continuing operations           | (7,407)                        | (9,609)     | (18,858)                     | (18,484)    |
| Loss from discontinued operations, net of tax | (1,024)                        | (4,232)     | (8,100)                      | (7,039)     |
| Net loss                                      | \$ (8,431)                     | \$ (13,841) | \$ (26,958)                  | \$ (25,523) |

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.



**Table of Contents****Clariant**

In connection with the audit of Clariant's financial statements as of December 31, 2007 and for the year then ended, Clariant's independent auditors determined that there was substantial doubt about Clariant's ability to continue as a going concern. In February 2009, Clariant's bank credit facility in the amount of \$12.0 million will expire, at which time Clariant will need to extend, renew or refinance such debt and possibly secure additional debt or equity financing in order to fund anticipated working capital needs and capital expenditures and to execute its strategy. Clariant's management believes that its current cash resources, revenue from operations and commitments under its credit facilities will enable Clariant to maintain current operations through at least the next twelve months and fund anticipated capital expenditures and implementation of its strategy. See Liquidity and Capital Resources - Consolidated Partner Company below.

The financial information presented below does not include the results of operations of Clariant's technology group, which is included in discontinued operations for all periods presented. Clariant sold this business (which developed, manufactured and marketed the ACIS Automated Image Analysis System) and related intellectual property to Carl Zeiss MicroImaging, Inc. (the ACIS Sale) for cash proceeds of \$11.0 million, excluding contingent purchase price of \$1.5 million. In 2007, prior to its sale, the technology group generated revenue of \$0.8 million and net loss from operations of \$0.6 million.

|                                     | <b>Three Months Ended June</b> |             | <b>Six Months Ended June</b> |             |
|-------------------------------------|--------------------------------|-------------|------------------------------|-------------|
|                                     | <b>30,</b>                     |             | <b>30,</b>                   |             |
|                                     | <b>2008</b>                    | <b>2007</b> | <b>2008</b>                  | <b>2007</b> |
|                                     | <b>(In thousands)</b>          |             |                              |             |
| Revenue                             | \$ 16,916                      | \$ 9,873    | \$ 32,802                    | \$ 18,702   |
| Operating expenses:                 |                                |             |                              |             |
| Cost of sales                       | 6,895                          | 5,519       | 13,003                       | 10,616      |
| Selling, general and administrative | 11,764                         | 7,126       | 21,712                       | 14,152      |
| Total operating expenses            | 18,659                         | 12,645      | 34,715                       | 24,768      |
| Operating loss                      | (1,743)                        | (2,772)     | (1,913)                      | (6,066)     |
| Other loss, net                     |                                | (44)        |                              |             |
| Interest, net                       | (131)                          | (237)       | (446)                        | (611)       |
| Minority interest                   | 1,769                          | 1,304       | 2,156                        | 2,954       |
| Net loss before income taxes        | \$ (105)                       | \$ (1,749)  | \$ (203)                     | \$ (3,723)  |

Clariant is a comprehensive cancer diagnostics company providing cellular assessment and cancer characterization to community pathologists, academic researchers, university hospitals and biopharmaceutical companies.

The decision to provide in-house laboratory services was made in 2004 to give Clariant an opportunity to capture a significant service-related revenue stream over the much broader and expanding cancer diagnostic testing marketplace. Clariant believes it is well positioned to participate in this growth due to its strength as a cancer diagnostics laboratory, deep domain expertise and access to intellectual property which can contribute to the development of additional tests, unique analytical capabilities and other service offerings.

Clariant operates primarily in one business, the delivery of critical oncology testing services to community pathologists, biopharmaceutical companies and other researchers.

As of June 30, 2008, we owned a 58.3% voting interest in Clariant.

*Three months ended June 30, 2008 versus the three months ended June 30, 2007*

*Revenue.* Revenue of \$16.9 million for the three months ended June 30, 2008 increased 71.3% or \$7.0 million from \$9.9 million for the prior year period. This increase resulted from the execution of Clariant's marketing and sales strategy to increase its sales to new and existing customers. Clariant added 53 new customers in the three months ended June 30, 2008 and increased its penetration of existing customers. In addition, Clariant increased its breadth of offerings to include multiple cancer types, including expanding its lymphoma/leukemia business, and performing testing in other solid tumors such as colon, prostate and lung. Clariant's testing was performed using its expanded capabilities in immunohistochemistry, flow cytometry, fluorescent in situ hybridization ( FISH ) and polymerase chain reaction ( PCR ). Clariant also increased its depth of offerings within each cancer type. Clariant also benefited from an overall increase in Medicare reimbursement rates in the first quarter of 2008, for certain tests it performs. In addition to the Medicare reimbursement rate increase, many of the Clariant's third-party contract rates are tied to Medicare rates, which consequently, also increased. Clariant anticipates that revenues will continue to increase as a result of increased revenue from existing customers, the addition of new customers and

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its offering of a more comprehensive suite of advanced and/or proprietary cancer diagnostic tests. In July 2008, the Medicare rate increase was extended 18 months effective July 1, 2008, to December 31, 2009.

*Cost of Sales.* Cost of sales for the three months ended June 30, 2008 was \$6.9 million compared to \$5.5 million in the prior year period, an increase of 24.9%. The \$1.4 million increase was primarily due to an increase of laboratory personnel, lab-related depreciation expense, laboratory reagents and supplies of \$0.1 million, the cost of tests performed by other laboratories of \$0.9 million and other direct costs such as shipping of \$0.4 million. Gross margin in the second quarter of 2008 was 59.2% compared to 44.1% in the prior year period. The increase in gross margin in the second quarter of 2008 was driven by the increase in revenue, test volume growth, higher value services mix, the increase in reimbursement rates and higher employee productivity. Clariant anticipates that gross margins will modestly increase as the company more effectively utilizes its capacity and expands its breadth of test offerings. Since current Medicare rates are only effective until December 31, 2009, gross margins could decline if Medicare institutes a reduced fee schedule at that time.

*Selling, General and Administrative.* Selling, general and administrative expenses in the second quarter of 2008 were \$11.8 million, an increase of approximately \$4.6 million, or 65.1%, compared to \$7.1 million in the prior year period. As a percentage of revenue, these expenses decreased to 69.5% in the second quarter of 2008 compared to 72.2% in the prior year period. The increase in expenses in 2008 was primarily due to an increase in severance costs of \$0.7 million, professional fees of \$0.4 million, billing costs of \$0.5 million, bad debt expense of \$1.4 million and selling, marketing and information management costs of \$1.6 million. Clariant anticipates that selling expenses and bad debt expenses will continue to grow as a result of its expected revenue growth, though the company expects general and administrative expenses to decline as a percentage of revenue as its infrastructure costs stabilize.

*Interest, Net.* Interest expense and other income totaled \$0.1 million and \$0.3 million for the three months ended June 30, 2008 and 2007, respectively. The decrease was primarily due to a decrease in the level of third party outstanding borrowings.

*Net Loss Before Income Taxes.* Net loss before income taxes decreased \$1.6 million, or 94.0%, in the first quarter of 2008 as compared to the prior year period. The improvement was related to increases in revenue and improved gross margin, partially offset by increases in selling, general and administrative expenses.

*Six months ended June 30, 2008 versus the six months ended June 30, 2007*

*Revenue.* Revenue of \$32.8 million for the six months ended June 30, 2008 increased 75.4% or \$14.1 million from \$18.7 million for the prior year period. This increase resulted from the execution of Clariant's marketing and sales strategy to increase its sales to new and existing customers. Clariant added 99 new customers in the six months ended June 30, 2008 and increased its penetration of existing customers. In addition, Clariant increased its breadth of offerings to include multiple cancer types, including expanding its lymphoma/leukemia business, and performing testing in other solid tumors such as colon, prostate and lung. Clariant's testing was performed using its expanded capabilities in immunohistochemistry, flow cytometry, FISH and PCR. Clariant also increased its depth of offerings within each cancer type. Clariant also benefited from an overall increase in Medicare reimbursement rates in the first quarter of 2008, for certain tests it performs. In addition to the Medicare reimbursement rate increase, many of the Clariant's third-party contract rates are tied to Medicare rates, which consequently, also increased.

*Cost of Sales.* Cost of sales for the six months ended June 30, 2008 was \$13.0 million compared to \$10.6 million in the prior year period, an increase of 22.5%. The \$2.4 million increase was primarily due to an increase of laboratory personnel, lab-related depreciation expense of \$0.1 million, laboratory reagents and supplies of \$0.4 million, the cost of tests performed by other laboratories of \$1.2 million, and other direct costs such as shipping of \$0.6 million. Gross margin in the first half of 2008 was 60.4% compared to 43.2% in the prior year period. The increase in gross margin in the second quarter of 2008 was driven by the increase in revenue, test volume growth, higher value services mix, the increase in reimbursement rates and higher employee productivity.

*Selling, General and Administrative.* Selling, general and administrative expenses in the first half of 2008 were \$21.7 million, an increase of approximately \$7.6 million, or 53.4%, compared to \$14.2 million in the prior year period. As a percentage of revenue these costs decreased to 66.2% in the first half of 2008 compared to 75.7% in the prior year period. The increase in expenses in 2008 was primarily due to an increase in severance costs of \$0.7 million, professional fees of \$1.1 million, billing costs of \$0.5 million, bad debt expense of \$2.7 million and

selling, marketing and information management costs of \$2.6 million.

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*Interest, Net.* Interest expense and other income totaled \$0.4 million and \$0.6 million for the six months ended June 30, 2008 and 2007, respectively. The decrease was primarily due to a decrease in the level of third party outstanding borrowings.

*Net Loss Before Income Taxes.* Net loss before income taxes decreased \$3.5 million, or 94.5%, in the first half of 2008 as compared to the prior year period. The improvement was related to increases in revenue and improved gross margin, partially offset by increases in selling, general and administrative expenses.

**Life Sciences**

The following partner companies were included in Life Sciences during the three and six months ended June 30, 2008:

| Partner Company                 | Safeguard<br>Ownership | Accounting<br>Method |
|---------------------------------|------------------------|----------------------|
| Advanced BioHealing, Inc.       | 28.3%                  | Equity method        |
| Avid Radiopharmaceuticals, Inc. | 14.1%                  | Cost method          |
| Alverix, Inc.                   | 50.0%                  | Equity method        |
| Cellumen, Inc.                  | 40.3%                  | Equity method        |
| NuPathe, Inc.                   | 27.8%                  | Equity method        |
| Rubicor Medical, Inc.           | 35.7%                  | Equity method        |

The following partner companies were included in Life Sciences during the three and six months ended June 30, 2007:

| Partner Company                | Safeguard<br>Ownership | Accounting<br>Method |
|--------------------------------|------------------------|----------------------|
| Advanced BioHealing, Inc.      | 23.9%                  | Equity method        |
| Neuronyx, Inc.                 | 7.0%                   | Cost method          |
| NuPathe, Inc.                  | 21.3%                  | Equity method        |
| Rubicor Medical, Inc.          | 35.8%                  | Equity method        |
| Ventaira Pharmaceuticals, Inc. | 12.8%                  | Cost method          |

|                              | Three Months Ended June<br>30, |            | Six Months Ended June<br>30,  |            |
|------------------------------|--------------------------------|------------|-------------------------------|------------|
|                              | 2008                           | 2007       | 2008                          | 2007       |
|                              | (In thousands)<br>(unaudited)  |            | (In thousands)<br>(unaudited) |            |
| Other loss                   | \$                             | \$ (800)   | \$                            | \$ (800)   |
| Equity loss                  | \$ (3,563)                     | \$ (2,144) | \$ (7,949)                    | \$ (3,320) |
| Net loss before income taxes | \$ (3,563)                     | \$ (2,944) | \$ (7,949)                    | \$ (4,120) |

*Equity Loss.* Equity 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 loss for Life Sciences increased \$1.4 million and \$4.6 million in the three and six months ended June 30, 2008, respectively, compared to the prior year periods. The increase in equity loss was due to an increase in the number of equity method partner companies, each of which generated losses, and larger losses incurred at certain

partner companies. Other loss for the three and six months ended June 30, 2007 reflects an impairment charge for Ventaira Pharmaceuticals, Inc.

**Technology**

The following partner companies were included in Technology during the three and six months ended June 30, 2008:

| Partner Company                      | Safeguard<br>Ownership | Accounting<br>Method |
|--------------------------------------|------------------------|----------------------|
| Advantage Healthcare Solutions, Inc. | 37.9%                  | Equity method        |
| Authentium, Inc.                     | 19.9%                  | Cost method          |
| Beyond.com, Inc.                     | 37.1%                  | Equity method        |
| Bridgevine, Inc.                     | 20.8%                  | Equity method        |
| NextPoint Networks, Inc.             | 12.2%                  | Cost method          |
| Portico Systems, Inc.                | 46.8%                  | Equity method        |
| Stealth Company                      | 14.0%                  | Cost method          |

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The following partner companies were included in Technology during the three and six months ended June 30, 2007:

| Partner Company                      | Safeguard<br>Ownership | Accounting<br>Method |
|--------------------------------------|------------------------|----------------------|
| Advantage Healthcare Solutions, Inc. | 32.2%                  | Equity method        |
| Authentium, Inc.                     | 12.4%                  | Cost method          |
| Beyond.com, Inc.                     | 37.1%                  | Equity method        |
| NexTone, Inc.                        | 16.5%                  | Cost method          |
| Portico Systems, Inc.                | 46.9%                  | Equity method        |
| ProModel Corporation                 | 49.7%                  | Equity method        |

|                              | Three Months Ended June<br>30,        |            | Six Months Ended June<br>30,          |            |
|------------------------------|---------------------------------------|------------|---------------------------------------|------------|
|                              | 2008<br>(In thousands)<br>(unaudited) | 2007       | 2008<br>(In thousands)<br>(unaudited) | 2007       |
| Equity loss                  | \$ (1,664)                            | \$ (1,255) | \$ (3,451)                            | \$ (1,841) |
| Net loss before income taxes | \$ (1,664)                            | \$ (1,255) | \$ (3,451)                            | \$ (1,841) |

*Equity Loss.* Equity loss fluctuates with the number of Technology partner companies accounted for under the equity method, our voting ownership percentage in these partner companies and the net results of operations of these partner companies. We recognize our share of losses to the extent we have cost basis in the equity partner company or 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 loss for Technology increased \$0.4 million and \$1.6 million in the three and six months ended June 30, 2008, respectively, compared to the prior year periods. The increase was due to an increase in the number of equity method partner companies each of which generated losses, and larger losses incurred at certain partner companies.

**Corporate Operations**

|                                       | Three Months<br>Ended June 30, |            | Six Months Ended June<br>30, |            |
|---------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                       | 2008                           | 2007       | 2008                         | 2007       |
|                                       | (In thousands)<br>(unaudited)  |            |                              |            |
| General and administrative costs, net | \$ (4,119)                     | \$ (4,326) | \$ (8,852)                   | \$ (9,541) |
| Stock-based compensation              | 49                             | (1,087)    | (469)                        | (2,094)    |
| Depreciation                          | (47)                           | (52)       | (93)                         | (104)      |
| Interest income                       | 782                            | 2,142      | 1,707                        | 4,260      |
| Interest expense                      | (1,052)                        | (1,053)    | (2,107)                      | (2,110)    |
| Other income                          | 2,266                          | 56         | 2,627                        | 111        |
| Equity (loss) income                  | 50                             | (51)       | (64)                         | (18)       |
|                                       | \$ (2,071)                     | \$ (4,371) | \$ (7,251)                   | \$ (9,496) |

*Three months ended June 30, 2008 versus the three months ended June 30, 2007*

*General and Administrative Costs.* Our general and administrative expenses consist primarily of employee compensation, insurance, outside services such as legal, accounting and travel-related costs. General and administrative costs decreased \$0.2 million as compared to the prior year period. The decrease is primarily attributable to a \$0.2 million decrease in employee costs.

*Stock-Based Compensation.* Stock-based compensation consists primarily of expense related to stock option grants and grants of restricted stock and deferred stock units to our employees. The \$1.1 million decrease relates to stock option forfeitures during the current period. Stock-based compensation expense related to corporate operations is included in selling, general and administrative in the Consolidated Statements of Operations.



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*Interest Income.* Interest income includes all interest earned on available cash and marketable security balances. Interest income decreased \$1.4 million in the second quarter of 2008 compared to the prior year period due to a decrease in interest rate returns and a decrease in average invested cash balances.

*Interest Expense.* Interest expense is primarily related to our 2.625% convertible senior debentures with a stated maturity of 2024. Interest expense remained consistent in the three and six months ended June 30, 2008 as compared to the prior year periods.

*Other income.* Other income for the three months ended June 30, 2008 was primarily related to the net gain on the sale of companies, including the receipt of escrowed funds from a legacy asset, and distributions from certain private equity funds accounted for under the cost method.

*Equity (loss) income.* Equity (loss) income was from our equity (loss) income for private equity holdings accounted for under the equity method.

*Six months ended June 30, 2008 versus the six months ended June 30, 2007*

*General and Administrative Costs.* Our general and administrative expenses consist primarily of employee compensation, insurance, outside services such as legal, accounting and travel-related costs. General and administrative costs decreased \$0.7 million as compared to the prior year period. The decrease is primarily attributable to a \$0.2 million decrease in employee costs, and a \$0.6 million decrease in professional fees, partially offset by a \$0.1 million adjustment to a tax accrual in the prior 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. The \$1.6 million decrease relates to stock option forfeitures during the period. Stock based compensation expense related to corporate operations is included in selling, general and administrative in the Consolidated Statements of Operations.

*Interest Income.* Interest income includes all interest earned on available cash and marketable security balances. Interest income decreased \$2.6 million in the six months ended June 30, 2008 compared to the prior year period due to a decrease in interest rate returns on lower average invested cash balances.

*Interest Expense.* Interest expense is primarily related to our 2.625% convertible senior debentures with a stated maturity of 2024. Interest expense remained consistent in the three and six months ended June 30, 2008 as compared to the prior year periods.

*Other income.* Other income for the six months ended June 30, 2008 is primarily related to the net gain on the sale of companies, including the receipt of escrowed funds from a legacy asset, and distributions from certain private equity funds accounted for under the cost method.

*Equity (loss) income.* Equity (loss) income was from our equity (loss) income for private equity holdings accounted for under the equity method.

**Income Tax Expense**

Income tax expense for the three and six months ended June 30, 2008 was \$4 thousand. Consolidated income tax benefit was \$710 thousand and \$696 thousand for the three and six months ended June 30, 2007, respectively. We have recorded a valuation allowance to reduce our net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the benefit of the net operating loss that would have been recognized in 2008 and 2007 was offset by a valuation allowance. The net tax benefit recognized in the three and six months ended June 30, 2007 resulted from the reversal of reserves that related to uncertain tax positions for which the statute of limitations expired during the period in the applicable tax jurisdictions.

**Table of Contents*****Discontinued Operations***

Of the companies included in the Bundle Transaction, Acsis, Alliance Consulting and Laureate Pharma were majority-owned partner companies; Neuronix and ProModel were minority-owned partner companies. The Bundle Transaction was consummated on May 6, 2008. We have presented the results of operations of Acsis, Alliance Consulting and Laureate Pharma as discontinued operations for all periods presented. The gross proceeds from the Bundle Transaction were \$74.5 million, of which \$6.4 million is to be held in escrow through April 2009, plus amounts advanced to certain of the Bundle Companies during the time between the signing of the Bundle Transaction agreement and its consummation. In the first quarter of 2008, we recognized an impairment loss of \$3.6 million to write down the aggregate carrying value of the Bundle Companies to the total proceeds, less estimated costs to complete the Bundle Transaction. In the second quarter of 2008, we recorded a charge of \$0.9 million in discontinued operations to accrue for severance payments due to the former CEO of Alliance Consulting in connection with the Bundle Transaction and we recorded a pre-tax gain on disposal of \$1.4 million.

In March 2007, we sold Pacific Title & Art Studio for net cash proceeds of approximately \$21.9 million, including \$2.3 million cash held in escrow. As a result of the sale, we recorded a pre-tax gain of \$2.7 million in the first quarter of 2007. During the first quarter of 2008, we recorded a charge of \$0.5 million in discontinued operations to adjust our accrual for amounts paid in April 2008 to the former CEO of Pacific Title & Art Studio in connection with the March 2007 sale. Pacific Title & Art Studio is reported in discontinued operations for all periods presented.

On March 8, 2007, Clariant sold its technology group (which developed, manufactured and marketed the ACIS Automated Image Analysis System) and related intellectual property to Zeiss MicroImaging, Inc. (the ACIS Sale) for net cash proceeds of \$11.0 million (excluding \$1.5 million in contingent purchase price). As a result of the sale, Clariant recorded a pre-tax gain of \$3.6 million in the first quarter of 2007. The technology group is reported in discontinued operations for all periods presented.

The loss from discontinued operations, net of tax in the first half of 2008 of \$8.1 million was primarily attributable to the \$3.6 million impairment loss recorded in the first quarter of 2008 related to the Bundle Transaction and the 2008 operating results of Acsis, Alliance Consulting and Laureate Pharma through May 6, 2008. The loss from discontinued operations in the first half of 2007 of \$7.0 million was primarily attributable to the loss from operations of Acsis, Alliance Consulting and Laureate Pharma, partially offset by the gain on sale of Pacific Title & Art Studio and the gain on sale of Clariant's technology group.

**Liquidity and Capital Resources*****Parent Company***

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 partner companies, sales of marketable securities and from equity and debt issuances has been adversely affected from time to time by adverse circumstances in the U.S. capital markets and other factors.

As of June 30, 2008, at the parent company level, we had \$150.5 million of cash and cash equivalents and \$2.2 million of marketable securities for a total of \$152.7 million. In addition to the amounts above, we had \$3.9 million in escrow associated with our interest payments due on our \$150.0 million of 2.625% convertible senior debentures with a stated maturity of March 15, 2024 (the 2024 Debentures) through March 2009, \$8.8 million of cash held in escrow, including accrued interest, and Clariant, our consolidated partner company, had cash and cash equivalents of \$2.1 million.

The Bundle Transaction closed on May 6, 2008. Gross proceeds were \$74.5 million in cash, of which \$6.4 million is to be held in escrow through April, 2009, plus amounts advanced to certain of the Bundle Companies during the time between the signing of the Bundle Transaction agreement and its consummation. Guarantees of partner company facilities of \$31.5 million were eliminated upon the closing of the Bundle Transaction.

On April 16, 2008 we received net cash proceeds of \$20.5 million that were released from escrow related to our October 2006 sale of Mantas, Inc.

In February 2004, we completed the sale of the 2024 Debentures. At June 30, 2008, we had \$129.0 million of the 2024 Debentures outstanding. Interest on the 2024 Debentures is payable semi-annually. At the holders' option, the

2024 Debentures are convertible into

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our common stock before the close of business on March 14, 2024 subject to certain conditions. The conversion rate of the 2024 Debentures is \$7.2174 of principal amount per share. The closing price of our common stock on June 30, 2008 was \$1.24. The 2024 Debentures holders have the right to require repurchase of the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount, plus accrued and unpaid interest. The 2024 Debenture holders also have the right to require repurchase of the 2024 Debentures upon certain events, including sale of all or substantially all of our common stock or assets, liquidation, dissolution or a change in control. Subject to certain conditions, we have the right to redeem all or some of the 2024 Debentures commencing March 20, 2009. During 2006, we repurchased \$21.0 million of face value of the 2024 Debentures for \$16.4 million in cash, including accrued interest. Our Board of Directors have authorized up to an additional repurchase of \$3.8 million of the 2024 Debentures.

On May 2, 2008, our Board of Directors authorized us, from time to time and depending on market conditions, to repurchase shares of our outstanding common stock, with up to an aggregate value of \$10.0 million, exclusive of fees and commissions. These repurchases, as well as any repurchases of 2024 Debentures, have and will be made in open market or privately negotiated transactions in compliance with the U.S. Securities and Exchange Commission and other applicable legal requirements. The manner, timing and amount of any purchases have and will be determined by us based upon an evaluation of market conditions, stock price and other factors. Our Board of Directors' authorizations regarding common stock and 2024 Debenture repurchases do not obligate us to acquire any particular amount of common stock or 2024 Debentures and may be modified or suspended at any time at our discretion. During the second quarter of 2008, we repurchased approximately 162 thousand shares of common stock at a total cost of \$0.2 million.

We maintain a revolving credit facility that provides for borrowings and issuances of letters of credit and guarantees up to \$30.0 million. This revolving credit facility expires on June 29, 2009. Borrowing availability under the facility is reduced by the amounts outstanding for our borrowings and letters of credit and amounts guaranteed under Clariant's facility maintained with that same lender. This credit facility bears interest at the prime rate (5.0% at June 30, 2008) for outstanding borrowings. The credit facility is subject to an unused commitment fee of 0.125%, which is subject to reduction based on deposits maintained at the bank. The credit facility requires us to maintain an unrestricted cash collateral account at that same bank, equal to our borrowings and letters of credit and amounts borrowed by Clariant under the guaranteed portion of its facility maintained with that same bank. At June 30, 2008, the required cash collateral, pursuant to the credit facility agreement was \$18.6 million, which amount is included within Cash and cash equivalents on our Consolidated Balance Sheet as of June 30, 2008.

Availability under our revolving credit facility at June 30, 2008 was as follows:

|  | <b>Total<br/>(In<br/>thousands)<br/>(unaudited)</b> |
|--|---|
| Size of facility                                 | \$ 30,000   |
| Guaranty of Clariant's facility at same bank (a) | (12,300)  |
| Outstanding letter of credit (b)                 | (6,336)   |
| Amount available at June 30, 2008                | \$ 11,364   |

(a) The Company's ability to borrow under its credit facility is limited by the amounts outstanding for

the Company's borrowings and letters of credit and amounts guaranteed under Clariant's facility maintained at the same bank.

- (b) In connection with the sale of CompuCom in 2004, we provided a letter of credit, to the landlord of CompuCom's Dallas headquarters which letter of credit will expire on March 19, 2019, in an amount equal to \$6.3 million.

On February 28, 2008, Clariant's bank credit facility was extended through February 26, 2009.

We have committed capital of approximately \$3.1 million, including conditional commitments to provide non-consolidated partner companies with additional funding and commitments made to various private equity funds in prior years. These commitments will be funded over the next several years, including approximately \$2.4 million which is expected to be funded in the next 12 months. We do not intend to commit to new investments in additional private equity funds and may seek to further reduce our current ownership interests in, and our existing commitments to, the funds in which we hold interests.

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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 or provide additional funding to existing partner companies, 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 loan agreement with Warren V. Musser, our former Chairman and Chief Executive Officer. In December 2006, we restructured the obligation to reduce the amount outstanding to \$14.8 million, bearing interest rate of 5.0% per annum. Cash payments, when received, are recognized as Recovery-related party in our Consolidated Statements of Operations. Since 2001 and through June 30, 2008 we received a total of \$16.3 million in cash payments on the loan, of which \$3 thousand was received during the first half 2008. The carrying value of the loan at June 30, 2008 was zero.

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 (the clawback). Assuming for these purposes only that the funds were liquidated or dissolved on June 30, 2008 and the only distributions from the funds were equal to the carrying value of the funds on the June 30, 2008 financial statements, the maximum clawback we would be required to return for our general partner interest is \$6.9 million. As of June 30, 2008, management estimated this liability to be approximately \$6.5 million, of which \$4.1 million was reflected in accrued expenses and other current liabilities and \$2.4 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet at June 30, 2008. We paid \$3.0 million of our estimated clawback liabilities in July 2008.

Our previous ownership in the general partners of the funds which 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 liability for the default of other general partners is remote.

For the reasons we presented above, we believe our cash and cash equivalents at June 30, 2008, 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 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.

***Consolidated Partner Company***

Clariant, our consolidated partner company, incurred losses in 2007 and the first half of 2008 and may need additional capital to fund their operations. From time-to-time, Clariant may require additional debt or equity financing or credit support from us to fund planned expansion activities. If we decide not to, or cannot provide sufficient capital resources to allow them to reach a positive cash flow position, and they are unable to raise capital from outside resources, they may need to scale back their operations. As described below, we have renewed, expanded and extended a revolving line of credit to Clariant. Alliance Consulting, Acsis and Laureate Pharma were among the Bundle Companies sold on May 6, 2008 as part of the Bundle Transaction. We will not have any continuing involvement with the funding requirements of these companies.

Clariant maintains a credit facility with its bank that provides for borrowings of up to \$12.0 million. This facility contains financial and non-financial covenants and matures February 26, 2009.

In March 2007, we provided a subordinated revolving credit line (the Mezzanine Facility) to Clariant. Under the Mezzanine Facility, we committed to provide Clariant access to up to \$12.0 million in working capital funding, which was reduced to \$6.0 million as a result of the ACIS Sale. The Mezzanine Facility originally had a term expiring on December 8, 2008. On March 14, 2008, the Mezzanine Facility was extended through April 15, 2009 and increased from \$6.0 million to \$21.0 million. In connection with the extension and increase of the Mezzanine Facility, we received from Clariant five-year warrants to purchase 1.6 million shares of Clariant common stock with an exercise

price of \$0.01 per share. The Mezzanine Facility is subject to reduction to \$6.0 million under certain circumstances involving the completion of replacement financing by Clariant. At June 30, 2008, \$12.4 million was outstanding under the Mezzanine Facility.

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In September 2006, Clariant entered into a \$5.0 million senior secured revolving credit agreement. Borrowing availability under the agreement was based on the amount of Clariant's qualified accounts receivable, less certain reserves. The agreement bore interest at variable rates based on the lower of 30-day LIBOR plus 3.25% or the prime rate plus 0.5%. On March 17, 2008, Clariant borrowed \$4.6 million under the Mezzanine Facility to repay and terminate this facility, and borrowed \$2.8 million under the Mezzanine Facility to repay and terminate its equipment line of credit with the same lender.

On July 31, 2008, Clariant entered into an \$8.0 million secured credit facility with Gemino Healthcare Finance, LLC. Actual availability under the facility is limited by Clariant's qualified accounts receivable and certain liquidity factors. Clariant repaid us \$4.9 million of indebtedness under the Mezzanine Facility with the proceeds borrowed from Gemino Healthcare Finance, LLC. See Note 17.

In connection with the audit of Clariant's financial statements as of December 31, 2007 and for the year then ended, Clariant's independent auditors determined that there was substantial doubt about Clariant's ability to continue as a going concern. In February 2009, Clariant's bank credit facility in the amount of \$12.0 million will expire, at which time Clariant will need to extend, renew or refinance such debt and possibly secure additional debt or equity financing in order to fund anticipated working capital needs and capital expenditures and to execute its strategy. Clariant management believes that its current cash resources, revenue from operations and commitments under its credit facilities will enable Clariant to maintain current operations and fund anticipated capital expenditures and implementation of its strategy.

***Analysis of Parent Company Cash Flows***

Cash flow activity for the Parent Company was as follows:

|   | <b>Six Months Ended June 30,</b> |             |
|---|----------------------------------|-------------|
|   | <b>2008</b>                      | <b>2007</b> |
|   | <b>(In thousands)</b>            |             |
| Net cash used in operating activities               | \$ (8,553)                       | \$ (9,350)  |
| Net cash provided by investing activities           | 64,560                           | 20,806      |
| Net cash (used in) provided by financing activities | (159)                            | 539         |
|   | \$ 55,848                        | \$ 11,995   |

***Cash Used In Operating Activities***

Cash used in operating activities decreased \$0.8 million. The change was primarily related to working capital changes.

***Net Cash Provided by Investing Activities***

Net cash provided by investing activities increased by \$43.8 million. The increase was primarily related to an increase of \$64.1 million in proceeds from sale of discontinued operations, a decrease of \$34.1 million in cash used in acquisitions of ownership interests in partner companies and funds and an increase of \$1.2 million in proceeds from sales of and distributions from companies and funds, partially offset by a \$41.9 million net decrease in cash from marketable securities and a \$13.8 million increase in cash used in advances to partner companies. Proceeds from sale of discontinued operations for the six month period ended June 30, 2008 includes net cash proceeds of \$65.7 million from the sale of Acsis, Alliance Consulting and Laureate as part of the Bundle Sale, excluding amounts held in escrow, and \$20.5 million net proceeds released from escrow related to our October 2006 sale of Mantas, Inc., partially offset by \$2.4 million paid to the former CEO of Pacific Title & Art Studio in connection with the March 2007 sale.

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

Net cash (used in) provided by financing activities decreased \$0.7 million due to a \$0.5 million decrease in proceeds from the issuance of common stock and \$0.2 million increase in repurchase of common stock.

***Consolidated Working Capital from Continuing Operations***



Consolidated working capital from continuing operations, excluding assets held for sale was \$153.1 million at June 30, 2008, an increase of \$57.4 million compared to December 31, 2007. The increase was primarily due to proceeds from the Bundle Sale (see Note 3).

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

Cash flow activity was as follows:

|   | <b>Six Months Ended June 30,</b> |                  |
|---|----------------------------------|------------------|
|   | <b>2008</b>                      | <b>2007</b>      |
|   | <b>(In thousands)</b>            |                  |
| Net cash used in operating activities               | \$ (13,375)                      | \$ (24,138)      |
| Net cash (used in) provided by investing activities | 72,372                           | 23,459           |
| Net cash (used in) provided by financing activities | (1,558)                          | 11,846           |
|   | <b>\$ 57,439</b>                 | <b>\$ 11,167</b> |

***Net Cash Used In Operating Activities***

Net cash used in operating activities decreased \$10.8 million in the first half of 2008 compared to the prior year period. The decrease was primarily related to working capital changes and a decrease in cash used in operating activities of discontinued operations.

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

Net cash used in investing activities increased \$48.9 million in the first half of 2008 compared to the prior year period. The increase was primarily related to an increase of \$53.8 million in proceeds from sale of discontinued operations, a decrease of \$34.1 million in cash used in acquisitions of ownership interests in partner companies and funds and a \$2.7 million decrease in cash used in investing activities by discontinued operations, partially offset by a \$41.9 million net decrease in cash from marketable securities. Proceeds from sale of discontinued operations for the six-month period ended June 30, 2008 includes net cash proceeds of \$65.7 million from the sale of Acsis, Alliance Consulting and Laureate as part of the Bundle Sale, excluding amounts held in escrow, and \$20.5 million net proceeds released from escrow related to our October 2006 sale of Mantas, Inc., partially offset by \$2.4 million paid to the former CEO of Pacific Title & Art Studio in connection with the March 2007 sale.

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

Net cash used in financing activities increased \$13.4 million in the first half of 2008 as compared to the prior year period. The increase was primarily related to increases in net repayments of revolving credit facilities and term debt of \$8.1 million and a \$5.0 million decrease in cash flows provided by financing activities of discontinued operations.

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

The following table summarizes our contractual obligations and other commercial commitments related to continuing operations as of June 30, 2008 by period due or expiration of the commitment.

|   | <b>Total</b>    | <b>Payments Due by Period</b> |                      |                      | <b>Due after 2013</b> |
|---|-----------------|-------------------------------|----------------------|----------------------|-----------------------|
|   |                 | <b>Rest of 2008</b>           | <b>2009 and 2010</b> | <b>2011 and 2012</b> |                       |
|   |                 |                               | <b>(In millions)</b> |                      |                       |
| Contractual Cash Obligations              |                 |                               |                      |                      |                       |
| Lines of credit (a)                       | \$ 9.0          | \$                            | \$ 9.0               | \$                   | \$                    |
| Capital leases                            | 0.6             | 0.1                           | 0.5                  |                      |                       |
| Convertible senior debentures (b)         | 129.0           |                               |                      |                      | 129.0                 |
| Operating leases                          | 15.5            | 0.9                           | 4.3                  | 4.4                  | 5.9                   |
| Funding commitments (c)                   | 3.0             | 1.8                           | 1.2                  |                      |                       |
| Potential clawback liabilities (d)        | 6.5             | 3.0                           | 3.5                  |                      |                       |
| Other long-term obligations (e)           | 2.4             | 0.3                           | 1.3                  | 0.8                  |                       |
| <b>Total Contractual Cash Obligations</b> | <b>\$ 166.0</b> | <b>\$ 6.1</b>                 | <b>\$ 19.8</b>       | <b>\$ 5.2</b>        | <b>\$ 134.9</b>       |

|                       | <b>Total</b> | <b>Amount of Commitment Expiration by Period</b> |                      |                      | <b>Due after 2012</b> |
|-----------------------|--------------|--|----------------------|----------------------|-----------------------|
|                       |              | <b>Rest of 2008</b>                              | <b>2009 and 2010</b> | <b>2011 and 2012</b> |                       |
|                       |              |  | <b>(in millions)</b> |                      |                       |
| Other Commitments     |              |  |                      |                      |                       |
| Letters of credit (f) | \$ 9.3       | \$   | \$ 3.0               | \$                   | \$ 6.3                |

(a) Clariant maintains a credit facility which we guarantee. Guarantees of \$31.5 million were eliminated upon the closing of the Bundle Transaction.

(b) In February 2004, we completed the issuance of \$150.0 million of the 2024 Debentures with

a stated maturity of March 15, 2024. During 2006, we repurchased \$21.0 million of the face value of the 2024 Debentures for \$16.4 million in cash. The 2024 Debenture holders have the right to require the Company to repurchase the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount, plus accrued and unpaid interest.

- (c) These amounts include 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. Also included are \$1.5 million conditional commitments to provide non-consolidated partner companies with additional

funding.

- (d) 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 (the clawback). Assuming the funds were liquidated or dissolved on June 30, 2008 and the only value provided by the funds was the carrying values represented on the June 30, 2008 financial statements, the maximum clawback we would be required to return is approximately \$6.9 million. As of June 30, 2008, management estimated its liability to be approximately \$6.5 million, of which \$4.1 million was

reflected in accrued expenses and other current liabilities and \$2.4 million was reflected in other long-term liabilities on the Consolidated Balance Sheets. We paid \$3.0 million of our estimated clawback liabilities in July 2008.

- (e) Reflects the amount payable to our former Chairman and CEO under a contract.
- (f) Letters of credit include a \$6.3 million letter of credit provided to the landlord of CompuCom's Dallas headquarters lease in connection with the sale of CompuCom in 2004 and \$3.0 million of letters of credit issued by Clariant supporting its office lease.

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We have employment agreements with certain executive officers that provide for severance payments to the executive officer in the event the officer is terminated without cause or in the event the officer terminates his employment for good reason. The maximum aggregate exposure under the agreements was approximately \$8.0 million at June 30, 2008.

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.

***Recent Accounting Pronouncements***

See Note 5 to the Consolidated Financial Statements.

**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 or results of operations could be materially harmed, and the value of our securities may decline. You should also refer to other information included or incorporated by reference in this report.

**Risks Related to our Business**

***Our 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 could decline. The risks relating to our partner companies include:

- § most of our partner companies have a history of operating losses or a limited operating history;
- § intensifying competition affecting the products and services our partner companies offer could adversely affect their businesses, financial condition, results of operations and prospects for growth;
- § inability to adapt to the rapidly changing marketplaces;
- § 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;
- § inability to protect their proprietary rights and/or infringing on the proprietary rights of others;
- § 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;
- § inability to attract and retain qualified personnel; and
- § government regulations and legal uncertainties may place financial burdens on the businesses of our partner companies.

These risks are discussed in greater 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 partner companies on which we focus;

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

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

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

Our consolidated financial results also may vary significantly based upon which partner companies are included in our financial statements. For example:

§ For the three and six months ended June 30, 2008, we consolidated the results of operations of Clariant in continuing operations. In our Form 10-K for the year ended December 31, 2007, we consolidated the results of operations of Acsis, Alliance Consulting, Clariant, and Laureate Pharma in continuing operations. The Bundle Transaction closed on May 6, 2008 and included the sale of three of our majority-owned partner companies Acsis, Alliance Consulting and Laureate Pharma.

***Our business model does not rely, or plan, upon the receipt of operating cash flows from our partner companies. Our partner companies currently 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 currently 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, 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 are likely to 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. For example, the aggregate market value of our holdings in Clariant (Nasdaq: CLRT), our only publicly listed partner company, at June 30, 2008 was approximately \$84.6 million, and at December 31, 2007 was approximately \$86.8 million.

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

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

We hold significant positions in our partner companies. Consequently, if we were to divest all or part of our holdings in a partner company, we may have to sell our interests at a relative discount to a price which may be received by a seller of a smaller portion. For partner companies with publicly traded stock, we may be unable to sell our holdings at then-quoted market prices. The trading volume and public float in the common stock of our publicly traded partner companies are 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.

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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.

***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 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 controlling interest in some of our partner companies, we may not maintain this controlling interest. 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 than ours; and
- § partner companies not taking our advice with respect to the financial or operating difficulties 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 recognize 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 majority-owned 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 technology and life sciences 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 majority 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 majority 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

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companies are acquired by third parties or if our partner companies issue stock which dilutes our majority ownership. 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.

***We have material weaknesses in our internal control over financial reporting and cannot provide assurance that additional material weaknesses will not be identified in the future. Our failure to effectively maintain our internal control over financial reporting could result in material misstatements in our financial statements which could require us to restate financial statements, cause us to fail to meet our reporting obligations, cause investors to lose confidence in our reported financial information or have a negative affect on our stock price.***

We determined that we had deficiencies in our internal control over financial reporting as of December 31, 2007 that constituted material weaknesses as defined by the Public Company Accounting Oversight Board's Audit Standard No. 5. These material weaknesses are identified in Item 9A, Controls and Procedures within our Annual Report on Form 10-K for the year ended December 31, 2007.

We cannot assure that additional 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 additional material weaknesses, or could result in material misstatements in our financial statements. These misstatements could result in a restatement of financial statements, cause us to fail to meet our reporting obligations 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 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.

***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. ***Our partner companies may fail if they do not adapt to the rapidly changing technology and life sciences marketplaces.***

If our partner companies fail to adapt to rapid 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;
- § frequent new products and services;



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- § 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 rapidly 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 rapid technology changes in an economically efficient manner, and our partner companies may become or remain unprofitable.

***Many of 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:

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

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

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

We cannot be certain that our partner companies will be able to obtain additional financing on favorable terms, if at all. Because our resources and our ability to raise capital are limited, we may not be able to provide our partner companies with sufficient capital resources to enable them to reach a cash flow positive position. We also may fail to accurately project the capital needs of our partner companies for purposes of our cash flow planning. If our 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.

***Our partner companies are subject to independent audits and the results of such independent audits could adversely impact our partner companies.***

As reported in its Form 10-K for the year ended December 31, 2007, Clariant's independent auditors determined that there was substantial doubt about Clariant's ability to continue as a going concern. The going concern explanatory paragraph in Clariant's audit opinion could have a negative impact on:

- § Clariant's ability to extend, renew or refinance its bank credit facility or to secure additional debt or equity financing in order to fund anticipated working capital needs and capital expenditures and to execute its strategy;
- § Clariant's relationships with existing customers or potential new customers; and
- § Clariant's stock price.

If any of such events were to occur, the value of our holdings in Clariant could be adversely impacted. *Some of our partner companies may be unable to protect their proprietary rights and may infringe on the proprietary rights of others.*

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Our partner companies assert various forms of intellectual property protection. Intellectual property may constitute an important part of our partner companies' 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, the complexity of international trade secret, copyright, trademark and patent law, coupled with the limited resources of these partner companies and the demands of quick delivery of products and services to market, create a risk that their efforts will prove inadequate to prevent misappropriation of our partner companies' technology, or third parties may develop similar technology independently.

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 our partner companies to costly litigation and the diversion of 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, may be 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.***

The manufacture and sale of certain of our partner companies' products entails an inherent risk of product liability. Certain of our partner companies maintain product liability insurance. Although none of our partner companies to date have experienced any material losses, there can be no assurance that they will be able to maintain or acquire adequate product liability insurance in the future and any product liability claim could have a material adverse effect on our partner companies' revenue and income. 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. The provisions our partner companies typically include in their contracts, which are designed to limit their exposure to legal claims relating to their services and the applications they develop, 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 are dependent 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. Some of our partner companies may have employees represented by labor unions. Although our existing 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.





**Table of Contents*****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.

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

We are exposed to equity price risks on the marketable portion of our securities. These securities include equity positions in partner companies, many of which have experienced significant volatility in their stock prices. Historically, we have not attempted to reduce or eliminate our market exposure on securities. Based on closing market prices at June 30, 2008, the fair market value of Clariant, our only publicly traded partner company, was approximately \$84.6 million. A 20% decrease in Clariant's stock price would result in an approximate \$16.9 million decrease in the fair value of our holding in Clariant.

In February 2004, we completed the issuance of \$150.0 million of our 2024 Debentures with a stated maturity of March 15, 2024. In 2006, we repurchased a total of \$21.0 million face value of the 2024 Debentures. Interest payments of approximately \$1.7 million each are due March and September of each year. The holders of these 2024 Debentures have the right to require repurchase of the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their face amount plus accrued and unpaid interest. In October 2004, we used approximately \$16.7 million of the proceeds from the CompuCom sale to escrow interest payments due through March 15, 2009.

|   | Remainder<br>of<br>2008 | 2009   | 2010   | After<br>2011 | Fair Market<br>Value<br>at<br>June 30, 2008 |
|---|-------------------------|--------|--------|---------------|---|
| Liabilities                               |                         |        |        |               |   |
| 2024 Debentures due by year (in millions) |                         |        |        | \$ 129.0      | \$ 96.6                                     |
| Fixed interest rate                       | 2.625%                  | 2.625% | 2.625% | 2.625%        | 2.625%                                      |
| Interest expense (in millions)            | \$ 1.7                  | \$ 3.4 | \$ 3.4 | \$ 44.7       | N/A   |

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**Item 4. 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, because of material weaknesses in internal control over financial reporting discussed in Management's Report on Internal Control Over Financial Reporting included in our Annual Report on Form 10-K for the year ended December 31, 2007 that were not remediated as of June 30, 2008, our disclosure controls and procedures were not effective 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.

In light of these unremediated material weaknesses, we performed additional post-closing procedures and analyses in order to prepare the Consolidated Financial Statements included in this report. As a result of these procedures, we believe our Consolidated Financial Statements included in this report present fairly, in all material respects, our financial condition, results of operations and cash flows for the periods presented. We have begun efforts to design and implement improvements in our internal control over financial reporting to address the material weaknesses as discussed in *Item 9A* to our Annual Report on Form 10-K for the year ended December 31, 2007.

On June 1, 2008, Clariant went live on its in-house billing and collection system as part of the transition away from its third-party billing provider who will continue to collect all outstanding accounts receivable dated prior to June 1, 2008. We believe that there were adequate controls in place at June 30, 2008 relating to the recording of Clariant's revenue transactions from the new system.

Other than the new billing and collection system referred to above, 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. Our business strategy involves the acquisition of interests in new businesses on an on-going basis, most of which are young, growing companies. Typically, these companies have not historically had all of the controls and procedures they would need to comply with the requirements of the Securities Exchange Act of 1934 and the rules promulgated thereunder. These companies also frequently develop new products and services. Following an acquisition, or the launch of a new product or service, we work with the company's management to implement all necessary controls and procedures.

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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, 2007.

***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 are likely to 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. For example, the aggregate market value of our holdings in Clariant (Nasdaq: CLRT) at June 30, 2008 was approximately \$84.6 million, and at December 31, 2007 was approximately \$86.8 million.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in this report and in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

***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 partner companies on which we focus;
- § sell some or all of our interests in any of our partner companies; or
- § otherwise change the nature of our interests in our partner companies.

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

Our consolidated financial results also may vary significantly based upon which partner companies are included in our financial statements. For example:

- § For the three and six months ended June 30, 2008, we consolidated the results of operations of Clariant in continuing operations. In our Annual Report on Form 10-K for the year ended December 31, 2007 we consolidated the results of operations of Acsis, Alliance Consulting, Clariant, and Laureate Pharma in continuing operations. The Bundle Transaction closed on May 6, 2008 and included the sale of three of our majority-owned partner companies—Acsis, Alliance Consulting and Laureate Pharma.

**Item 5. Other Information.**

None

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(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.

| <b>Exhibit Number</b> | <b>Description</b>   | <b>Incorporated Filing Reference</b> |                                |
|-----------------------|--|--------------------------------------|--------------------------------|
|                       |  | <b>Form Type &amp; Filing Date</b>   | <b>Original Exhibit Number</b> |
| 2.1                   | First Amendment to Purchase Agreement, dated May 6, 2008, by and between Safeguard Scientifics, Inc., as Seller, and Saints Capital Dakota, L.P., as Purchaser             | Form 8-K 5/7/08                      | 2.2                            |
| 10.1 *                | Management Incentive Plan  | Form 8-K 4/25/08                     | 10.1                           |
| 10.2 *                | Agreement by and between Safeguard Scientifics, Inc. and Stephen T. Zarrilli dated May 28, 2008  | Form 8-K 5/29/08                     | 10.1                           |
| 10.3 *                | Stock option grant certificates issued to Stephen T. Zarrilli dated June 30, 2008  |                                      |                                |
| 10.4 *                | Agreement by and between Safeguard Scientifics, Inc. and Kevin L. Kemmerer dated September 15, 2006  |                                      |                                |
| 10.5.1 *              | Stock option grant certificate issued to Kevin L. Kemmerer dated October 25, 2005  |                                      |                                |
| 10.5.2 *              | Stock option grant certificate issued to Kevin L. Kemmerer dated February 21, 2006   |                                      |                                |
| 10.5.3 *              | Stock option grant certificate issued to Kevin L. Kemmerer dated June 30, 2008   |                                      |                                |
| 10.6 *                | Compensation Summary Non-Employee Directors  |                                      |                                |
| 10.7 *                | Compensation Summary Julie A. Dobson   |                                      |                                |
| 10.8.1                | Amended and Restated Loan and Security Agreement by and among Comerica Bank, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. dated as of June 30, 2008 | Form 8-K 7/2/08                      | 10.1                           |
| 10.8.2                | Amendment and Affirmation of Guaranty from Safeguard Scientifics, Inc. to Comerica Bank dated as of June 30, 2008  |                                      |                                |

|       |  |     |      |
|-------|--|-----|------|
| 10.9  | First Amendment and Waiver of Amended and Restated Senior Subordinated Revolving Credit Agreement, dated July 31, 2008, by and between Clariant, Inc. and Safeguard Delaware, Inc. | (1) | 10.3 |
| 10.10 | Third Amendment and Waiver to Amended and Restated Loan Agreement, dated as of July 31, 2008, by and between Comerica Bank and Clariant, Inc.                                      | (1) | 10.2 |
| 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.                                     |     |      |

Filed herewith

\* Management contracts or compensatory plans, contracts or arrangements in which directors and/or executive officers of the Registrant may participate.

(1) Incorporated by reference to the Current Report on Form 8-K filed on August 4, 2008 by Clariant, Inc. (SEC File No. 000-22677).

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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: August 11, 2008

PETER J. BONI

Peter J. Boni  
*President and Chief Executive Officer*

Date: August 11, 2008

STEPHEN T. ZARRILLI

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