

SAFEGUARD SCIENTIFICS INC

Form 10-Q

October 25, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-5620

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Safeguard Scientifics, Inc.

(Exact name of registrant as specified in its charter)

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Pennsylvania

(State or other jurisdiction of  
incorporation or organization)

23-1609753

(I.R.S. Employer ID No.)

170 North Radnor-Chester Road

Suite 200

Radnor, PA

19087

(Address of principal executive offices) (Zip Code)

(610) 293-0600

Registrant's telephone number, including area code

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

Yes  No

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

Yes  No

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

Large accelerated filer  Accelerated filer  Smaller reporting company

Non-accelerated filer

Emerging growth company

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

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

Yes " No

Number of shares outstanding as of October 23, 2018

Common Stock 20,647,178

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

	September 30, 2018	December 31, 2017
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 44,522	\$ 20,751
Marketable securities	25,114	4,452
Trading securities	1,307	3,761
Prepaid expenses and other current assets	2,098	4,644
Total current assets	73,041	33,608
Property and equipment, net	1,293	1,513
Ownership interests in and advances to partner companies	103,702	134,691
Long-term restricted cash equivalents	—	6,336
Other assets	316	316
Total Assets	\$ 178,352	\$ 176,464
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 17	\$ 155
Accrued compensation and benefits	4,053	3,321
Accrued expenses and other current liabilities	2,213	1,851
Credit facility - current	16,433	—
Credit facility repayment feature	5,622	—
Convertible senior debentures	—	40,485
Total current liabilities	28,338	45,812
Credit facility - non-current	63,399	45,321
Other long-term liabilities	3,106	3,535
Total Liabilities	94,843	94,668
Commitments and contingencies (Note 10)		
Equity:		
Preferred stock, \$0.10 par value; 1,000 shares authorized	—	—
Common stock, \$0.10 par value; 83,333 shares authorized; 21,573 shares issued at September 30, 2018 and December 31, 2017	2,157	2,157
Additional paid-in capital	811,131	812,536
Treasury stock, at cost; 926 and 999 shares at September 30, 2018 and December 31, 2017, respectively	(15,284 )	(17,308 )
Accumulated deficit	(714,482 )	(715,476 )
Accumulated other comprehensive loss	(13 )	(113 )
Total Equity	83,509	81,796
Total Liabilities and Equity	\$ 178,352	\$ 176,464
See Notes to Consolidated Financial Statements.		

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
General and administrative expense	\$3,516	\$3,758	\$14,253	\$13,191
Operating loss	(3,516 )	(3,758 )	(14,253 )	(13,191 )
Other loss	(1,078 )	(379 )	(4,965 )	(219 )
Interest income	718	1,004	2,182	2,892
Interest expense	(3,310 )	(2,643 )	(9,422 )	(5,953 )
Equity income (loss)	39,246	(12,874 )	27,452	(53,373 )
Net income (loss) before income taxes	32,060	(18,650 )	994	(69,844 )
Income tax benefit (expense)	—	—	—	—
Net income (loss)	\$32,060	\$(18,650)	\$994	\$(69,844)
Net income (loss) per share:				
Basic	\$1.56	\$(0.91 )	\$0.05	\$(3.42 )
Diluted	\$1.56	\$(0.91 )	\$0.05	\$(3.42 )
Weighted average shares used in computing income (loss) per share:				
Basic	20,561	20,455	20,535	20,416
Diluted	20,561	20,455	20,535	20,416

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited - In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net income (loss)	\$32,060	\$(18,650)	\$994	\$(69,844)
Other comprehensive income (loss):				
Share of other comprehensive income of equity method investments	33	274	33	277
Reclassification adjustment for sale of equity method investments	(14 )	—	67	50
Total comprehensive income (loss)	\$32,079	\$(18,376)	\$1,094	\$(69,517)

See Notes to Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2018	2017
Cash Flows from Operating Activities:		
Net cash used in operating activities	\$(18,649)	\$(15,515)
Cash Flows from Investing Activities:		
Proceeds from sales of and distributions from companies	69,912	16,604
Acquisitions of ownership interests in companies	(3,250 )	(11,851 )
Advances and loans to companies	(12,098 )	(16,933 )
Repayment of advances and loans to companies	10,652	—
Purchases of marketable securities	(24,858 )	—
Proceeds, from sales and maturities in marketable securities	4,211	10,268
Proceeds from sales of property and equipment	1	—
Net cash provided by (used in) investing activities	44,570	(1,912 )
Cash Flows from Financing Activities:		
Proceeds from credit facility	35,000	50,000
Issuance costs of credit facility	(2,252 )	(5,696 )
Repurchase of convertible senior debentures	(41,000 )	(14,455 )
Issuance of Company common stock, net	—	12
Tax withholdings related to equity-based awards	(234 )	(175 )
Net cash provided by (used in) financing activities	(8,486 )	29,686
Net change in cash, cash equivalents and restricted cash equivalents	17,435	12,259
Cash, cash equivalents and restricted cash equivalents at beginning of period	27,087	28,394
Cash, cash equivalents and restricted cash equivalents at end of period	\$44,522	\$40,653
See Notes to Consolidated Financial Statements.		



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

	Total	Accumulated Deficit	Accumulated Other Comprehensive Loss	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Treasury Stock Shares	Treasury Stock Amount
Balance - December 31, 2017	\$81,796	\$(715,476 )	\$ (113 )	21,573	\$2,157	\$812,536	999	\$(17,308)
Net income	994	994	—	—	—	—	—	—
Stock options exercised, net of tax withholdings	—	—	—	—	—	(16 )	(1 )	16
Issuance of restricted stock, net of tax withholdings	(234 )	—	—	—	—	(2,242 )	(72 )	2,008
Stock-based compensation expense	853	—	—	—	—	853	—	—
Other comprehensive income	100	—	100	—	—	—	—	—
Balance - September 30, 2018	\$83,509	\$(714,482 )	\$ (13 )	21,573	\$2,157	\$811,131	926	\$(15,284)

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. General

The accompanying unaudited interim Consolidated Financial Statements of Safeguard Scientifics, Inc. (“Safeguard” or the “Company”) were prepared in accordance with accounting principles generally accepted in the United States of America and the interim financial statement rules and regulations of the SEC. In the opinion of management, these statements include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Consolidated Financial Statements. The interim operating results are not necessarily indicative of the results for a full year or for any interim period. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations relating to interim financial statements. The Consolidated Financial Statements included in this Form 10-Q should be read in conjunction with Management’s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-Q and with the Company’s Consolidated Financial Statements and Notes thereto included in the Company’s 2017 Annual Report on Form 10-K.

Liquidity

As of September 30, 2018, the Company had \$44.5 million of cash and cash equivalents and \$25.1 million of marketable securities for a total of \$69.6 million. As of September 30, 2018, the Company had \$85.0 million of principal outstanding on its Amended Credit Facility (as defined below) due in May 2020. The Company currently has \$15.0 million of availability under the Amended Credit Facility.

In January 2018, Safeguard announced that, from that date forward, the Company will not deploy any capital into new partner company opportunities and will focus on supporting its existing partner companies and maximizing monetization opportunities for partner company interests to enable distributions of net proceeds to shareholders. In that context, the Company will consider initiatives including, among others: the sale of individual partner companies, the sale of certain partner company interests in secondary market transactions, or a combination thereof, as well as other opportunities to maximize shareholder value. The Company anticipates distributing to shareholders net proceeds from the sale of partner companies or partner company interests, as applicable, after satisfying its debt obligations and working capital needs. In connection with the Company’s change in strategy, in January 2018, the Company implemented an initiative to reduce the operating costs of the Company. In April 2018, the Company announced additional management changes intended to further streamline the Company’s organizational structure and further reduce its operating costs. In connection with the changes that the Company has implemented, the Company will incur approximately \$4.0 million of severance payments to terminated employees that will be paid over approximately twelve months. The Company anticipates that with these organizational changes and cost reduction initiatives, its ongoing annualized operating expenses excluding interest, depreciation, severance and stock-based compensation, will approximate \$8 million to \$9 million.

In May 2017, the Company entered into a \$75.0 million secured, revolving credit facility (“Credit Facility”) with HPS Investment Partners, LLC (“Lender”). In May 2018, the Company and Lender amended the Credit Facility (“Amended Credit Facility”) to increase the principal amount of indebtedness available to be borrowed by the Company from \$75.0 million to \$100.0 million. The interest rate and maturity date of May 2020 remained unchanged. The Amended Credit Facility consists of a term loan in the principal amount of \$85.0 million, (the “Term Loan”), \$50.0 million of which was outstanding prior to entering into the amendment and \$35.0 million of which was drawn in connection with the consummation of the amendment, and a revolving loan in the principal amount of up to \$15.0 million (the “Revolving Loan”). The Company may borrow and repay under the Revolving Loan at any time until its expiration on December 30, 2018. Any amounts outstanding under the Revolving Loan on December 30, 2018 will be subject to the same repayment terms as amounts borrowed under the Term Loan. Repayment terms under the Amended Credit Facility include a make-whole interest provision equal to the interest that would have been payable had the principal amount subject to repayment been outstanding through the maturity date of the Amended Credit Facility. Under the Amended Credit Facility, if the aggregate amount of the Company’s qualified cash at any quarter end date exceeds \$50.0 million, the Company will be required to prepay outstanding principal amounts under the Amended Credit

Facility, plus any applicable accrued and make-whole interest, in an amount equal to 100% of such excess. Certain debt covenants were revised in connection with the Amended Credit Facility. The Amended Credit Facility requires the Company to (i) maintain a liquidity threshold of at least \$20 million of unrestricted cash; (ii) maintain a minimum aggregate appraised value of the Company's ownership interests in its partner companies, plus unrestricted cash in excess of the liquidity threshold, of at least \$350 million less the aggregate amount of all prepayments of the Term Loan and all prepayments of the Revolving Loan made after December 30, 2018; (iii) limit deployments to only existing partner companies and such deployments may not exceed, when combined with deployments after January 1, 2018, \$40.0 million in the aggregate through the maturity date; and (iv) limit certain expenses (which shall exclude severance payments, interest expense, depreciation and stock-based compensation) incurred or paid to no more than \$11.5 million in any twelve-month period after the date of the

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

amendment (or such shorter period as has elapsed since the date of the amendment). The Company is no longer required to maintain a specific net worth or any diversification requirements or concentration limits with respect to the Company's capital deployments to its partner companies. Additionally, under the Amended Credit Facility, the Company is restricted from repurchasing shares of its outstanding common stock and/or issuing dividends until such time as the Amended Credit Facility is repaid in full. As of the date these consolidated financial statements were issued, the Company was in compliance with all applicable covenants.

The \$35.0 million of additional principal that the Company borrowed with the consummation of the Amended Credit Facility resulted in net proceeds of \$32.7 million, after closing fees to the Lender and other third parties, that were used towards the repayment of \$41.0 million of principal outstanding on its 2018 Debentures, which the Company repaid in full on the maturity date of May 15, 2018. There were no convertible debentures outstanding as of September 30, 2018.

The Company funds its operations with cash and marketable securities on hand as well as proceeds from the sales of its interests in its partner companies. Due to the nature of the mergers and acquisitions market, and the developmental cycle of companies like the Company's partner companies, the Company's ability to generate specific amounts of liquidity from sales of its partner company interests in any given period of time cannot be assured. Accordingly, the forecasts which the Company utilizes for projecting future compliance with covenants related to its Amended Credit Facility include significantly discounted probability-weighted proceeds from the sales of its interests in its partner companies. Based on these forecasts, management believes the Company will remain in compliance with all its debt covenants. Non-compliance with any of the covenants would constitute an event of default under the Amended Credit Facility, and the Lender could choose to accelerate the maturity of the indebtedness. If the Lender chose not to provide a waiver and were to accelerate the maturity of the indebtedness, the Company may not have sufficient liquidity to repay the entire balance of its outstanding borrowings and other obligations under the Amended Credit Facility. In order for the Company to maintain compliance with these covenants, the Company's plan includes selling certain of its partner company interests in the ordinary course of its business and limiting capital deployments to existing partner companies, if necessary. Should the Company not be in compliance with any of its debt covenants and be unable to obtain waivers for such events of default, management would pursue one of a number of potential alternatives to satisfy the obligations, including completing an equity offering or obtaining a new debt facility to refinance its existing debt. The Company believes that its cash, cash equivalents and marketable securities at September 30, 2018 will be sufficient to fund operations past one year from the issuance of these financial statements.

## Significant Accounting Policies

## Restricted Cash Equivalents

Restricted cash equivalents in prior periods represented cash required to be set aside by a contractual agreement with a bank as collateral for a letter of credit. During the first quarter of 2018, the restriction on the cash lapsed in connection with the termination of the related letter of credit. The following table provides a reconciliation of cash, cash equivalents and restricted cash equivalents reported within the Consolidated Balance Sheets that sum to the total of the same such amounts shown in the Consolidated Statements of Cash Flows:

	September 30, 2018	December 31, 2017
	(Unaudited - In thousands)	
Cash and cash equivalents	\$44,522	\$ 20,751
Long-term restricted cash equivalents	—	6,336
Total cash, cash equivalents and restricted cash equivalents	\$44,522	\$ 27,087

## Recently Adopted Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 requires that equity investments (except those accounted for under the equity method of

accounting or those that result in consolidation of the investee) are to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Furthermore, equity investments without readily determinable fair values are to be assessed for impairment using a qualitative approach. The amendments in ASU 2016-01 should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption, with other amendments related specifically to equity securities without readily determinable fair values applied prospectively. The Company adopted the amendments in ASU 2016-01 when they became effective on January 1, 2018. The adoption of this guidance did not have a material impact upon the Company's financial condition or results of operations.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

## Recently Issued Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases. The guidance in ASU 2016-02 requires that a lessee recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. As with previous guidance, there continues to be a differentiation between finance leases and operating leases, however this distinction now primarily relates to differences in the manner of expense recognition over time and in the classification of lease payments in the statement of cash flows. Lease assets and liabilities arising from both finance and operating leases will be recognized in the statement of financial position. The transitional guidance for adopting the requirements of ASU 2016-02 calls for a modified retrospective approach that includes a number of optional practical expedients that entities may elect to apply. The guidance in ASU 2016-02 will become effective for the Company on January 1, 2019. The Company anticipates making the accounting policy election not to recognize lease assets and lease liabilities for leases with a term of 12 months or less. As of September 30, 2018, the Company's only material long-term lease was for its corporate headquarters in Radnor, PA under a lease expiring in 2026. The Company also has immaterial office equipment leases expiring at various dates through 2020. The Company is currently evaluating the impact that the adoption of ASU 2016-02 will have on its consolidated financial statements.

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

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

	September 30, 2018	December 31, 2017
	(Unaudited - In thousands)	
Equity Method Companies:		
Partner companies	\$71,248	\$ 107,646
Private equity funds	440	443
	71,688	108,089
Other Companies:		

Partner companies and other holdings	15,260	2,762
Private equity funds	1,311	1,334
	16,571	4,096
Advances to partner companies	15,443	22,506
	\$103,702	\$ 134,691

The Company recognized an impairment charge of its entire carrying value of \$4.8 million related to CloudMine, Inc. which is reflected in Equity income (loss) in the Consolidated Statements of Operations for the three and nine months ended September 30, 2018. The impairment results from our inability to recover the carrying value of the investment as the company has not identified new investors.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In July 2018, the Company sold 39.13% of its ownership position in MediaMath back to MediaMath for \$45.0 million. The Company also granted MediaMath an option to repurchase an additional 10.87% of the Company's ownership position in MediaMath for \$12.5 million within 180 days after the close of the initial transaction. The Company recognized a gain of \$45.0 million on the initial transaction, which was included in Equity income (loss) in the Consolidated Statements of Operations for the three and nine months ended September 30, 2018. The Company previously accounted for its ownership interest in MediaMath under the equity method of accounting. Immediately after the initial transaction, the Company discontinued utilizing the equity method of accounting for its remaining ownership interest in MediaMath. The Company's remaining ownership interest was recorded at its carrying value immediately prior to the initial transaction. The carrying value will be adjusted for any future impairments or observable price changes in the same or similar equity securities of MediaMath as those held by the Company.

In July 2018, the Company sold its interest in AdvantEdge Healthcare Solutions, Inc. in a secondary transaction for \$10.0 million, excluding an additional \$6.3 million that may be realized upon the achievement of certain valuation thresholds in connection with the future sale of Advantage Healthcare Solutions. The Company recognized a gain of \$5.5 million on the transaction, which was included in Equity income (loss) in the Consolidated Statements of Operations for the three and nine months ended September 30, 2018.

In May 2018, Cask Data, Inc. sold substantially all of its assets to another entity. The Company received \$11.5 million in cash proceeds in connection with the transaction, excluding \$2.4 million of holdbacks and escrows that may be released on various dates on or before November 2019. The Company recognized a gain of \$4.2 million on the transaction, which was included in Equity income (loss) in the Consolidated Statements of Operations for the three and nine months ended September 30, 2018.

The Company recognized an impairment charge of \$6.6 million related to Apprenda, Inc. which is reflected in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2018. The impairment was based on Apprenda's decision to discontinue operations. The adjusted carrying value of the Company's interest in Apprenda was \$0.0 million at September 30, 2018.

In February 2018, Nexxt, Inc., formerly Beyond.com, repaid \$10.5 million of principal outstanding on a note received in connection with the Company's sale of its interest back to Nexxt for \$26.0 million in March 2017. In that transaction, the Company received \$15.5 million in cash and a three-year, \$10.5 million note for the balance due, which accrued interest at a rate of 9.5% per annum. Interest was payable annually and interest income was recorded as earned throughout the year. The \$10.5 million note was fully reserved and had a carrying value of zero as of December 31, 2017. The Company waived the interest accrued to date in connection with the early repayment of the principal balance. The receipt of \$10.5 million of cash in February 2018 resulted in a gain of \$9.5 million, net of the interest accrued to date, which is included in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2018.

In January 2018, Spongecell, Inc. merged into Flashtalking, a privately-held company. The Company received Flashtalking ordinary shares equal to approximately 10% of Flashtalking's issued share capital at the time of the closing. The Company's final number of Flashtalking shares will be subject to customary indemnification and working capital provisions and agreements. The Company recorded its ownership interest in Flashtalking at \$11.2 million, which reflects its fair value at the time of closing. The Company recognized a gain of \$3.9 million on the transaction, which is included in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2018.

In February 2018, the Company sold 414,237 shares of Invitae Corporation ("Invitae") common stock on the open market for proceeds of \$2.6 million after transaction fees. The Company obtained shares of Invitae in August 2017 when Invitae, a public company, acquired former partner company Good Start Genetics, Inc. In that transaction, the Company received 414,237 shares of Invitae common stock, excluding 124,092 shares of Invitae common stock which will be held in escrow. During the third quarter, 78,103 additional shares were released from escrow and recorded as an additional gain of \$1.1 million from this transaction, which is included in Equity income (loss) in the Consolidated Statements of Operations for the three and nine months ended September 30, 2018. The Invitae shares



were classified as Trading securities and recorded at their fair value, which was \$1.3 million and \$3.8 million at September 30, 2018 and December 31, 2017, respectively. For the three and nine months ended September 30, 2018, the Company recorded a \$0.2 million gain and a \$1.0 million net loss, respectively, due to a change in the value of the Invitae shares, which is included in Other loss in the Consolidated Statements of Operations.

In January 2018, the Company received \$0.6 million of proceeds from the sale of the assets of Aventura, Inc., a former partner company that ceased operations and was fully impaired in 2016. The Company recognized a gain of \$0.6 million, which is reflected in Equity income (loss) in the Consolidated Statements of Operations for the nine months ended September 30, 2018.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## Summarized Financial Information

The Company discloses aggregate summarized statements of operations for any partner companies accounted for under the equity method that are deemed significant. The following table provides significant partner company operations information for the three and nine months ended September 30, 2018. The partner company results of operations have been compiled from respective partner company financial statements, reflect certain historical adjustments, and are reported on a one quarter lag basis. Results of operations of the partner companies are excluded for periods prior to their acquisition, subsequent to their disposition and subsequent to the discontinuation of equity method of accounting. Historical results are not adjusted when the Company exits, writes-off or discontinues the equity method of accounting for a partner company.

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017

(Unaudited - In thousands)

## Results of Operations:

Revenue	\$40,070	\$91,137	\$234,049	\$275,154
Gross profit	\$21,822	\$60,836	\$153,387	\$180,158
Net loss	\$(34,885)	\$(52,648)	\$(120,971)	\$(148,439)

## 3. Acquisitions of Ownership Interests in Partner Companies

## Third quarter of 2018

The Company funded an aggregate of \$0.7 million of term notes to InfoBionic, Inc. The Company had previously deployed an aggregate of \$21.3 million in InfoBionic. InfoBionic is an emerging digital health company focused on creating patient monitoring solutions for chronic disease management with an initial market focus on cardiac arrhythmias. The Company accounts for its interest in InfoBionic under the equity method.

The Company deployed an additional \$1.0 million in meQuilibrium. The Company had previously deployed an aggregate of \$10.5 million in meQuilibrium. meQuilibrium is a digital coaching platform that delivers clinically validated and highly personalized resilience solutions to employers, health plans, wellness providers and consumers increasing engagement, productivity and performance, as well as improving outcomes in managing stress, health and well-being. The Company accounts for its interest in meQuilibrium under the equity method.

The Company funded an additional \$1.0 million of convertible bridge loans to Moxe Health Corporation. The Company had previously deployed \$4.5 million in Moxe Health. Moxe Health connects payers to their provider networks, facilitating real-time data exchange through its electronic integration platform. The Company accounts for its interest in Moxe Health under the equity method.

The Company funded an additional \$1.5 million in Zipnosis, Inc. The Company had previously deployed \$7.0 million in Zipnosis. Zipnosis provides health systems with a white-labeled, fully integrated virtual care platform. The Company accounts for its interest in Zipnosis under the equity method.

The Company deployed an aggregate of \$0.4 million of convertible bridge loans to CloudMine, Inc. The Company had previously deployed an aggregate of \$10.5 million in CloudMine. CloudMine empowers healthcare organizations to rapidly and confidently develop connected digital health experiences by reducing complexity, enabling data mobility, and ensuring compliance. The Company accounts for its interest in CloudMine under the equity method.

The Company funded an additional \$0.5 million in Aktana, Inc. The Company had previously deployed \$9.7 million in Aktana. Aktana leverages big data and machine learning to enable pharmaceutical brands to dynamically optimize their strategy and enhance sales execution. The Company accounts for its interest in Aktana under the equity method.

The Company funded an additional \$1.4 million of convertible bridge loans to QuanticMind, Inc. The Company had previously deployed \$11.5 million in QuanticMind. QuanticMind delivers the most intelligent, scalable and fastest platform for maximizing digital marketing performance, including paid search and social, for enterprises. The

Company accounts for its interest in QuanticMind under the equity method.

The Company funded an additional \$0.5 million of convertible bridge loans to Sonobi, Inc. The Company had previously deployed \$10.9 million in Sonobi. Sonobi is an advertising technology developer that designs advertising tools and solutions for the industry's leading media, publishers, brand advertisers, media agencies, DSPs, and media technology providers. The Company accounts for its interest in Sonobi under the equity method.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Second quarter of 2018

The Company funded an aggregate of \$1.5 million of a convertible bridge loan to Sonobi, Inc.

The Company funded an aggregate of \$0.8 million of convertible bridge loans to InfoBionic, Inc.

The Company deployed an aggregate of \$0.5 million of convertible bridge loans to CloudMine, Inc.

The Company funded an aggregate of \$0.2 million of convertible bridge loans to WebLinc, Inc. The Company had previously deployed an aggregate of \$14.5 million in WebLinc. WebLinc is an e-commerce platform and services provider for fast growing online retailers. The Company accounts for its interest in WebLinc under the equity method. The Company deployed an additional \$0.3 million in Propeller Health, Inc. The Company had previously deployed an aggregate of \$14.0 million in Propeller Health. Propeller Health provides digital solutions to measurably improve respiratory health. The Company accounts for its interest in Propeller Health under the equity method.

The Company funded an aggregate of \$0.2 million of convertible bridge loans to Cask Data, Inc. The Company had previously deployed an aggregate of \$13.3 million in Cask Data. Cask Data made building and running big data solutions on-premises or in the cloud easy with Cask Data Application Platform. In May 2018, Cask Data sold substantially all of its assets to another entity. The Company had previously accounted for its interest in Cask Data under the equity method.

The Company funded an aggregate of \$0.8 million of convertible loans to NovaSom, Inc. The Company had previously deployed an aggregate of \$25.4 million in NovaSom. NovaSom is a medical device company focused on obstructive sleep apnea, specifically home testing with its FDA-cleared wireless device called AccuSom<sup>®</sup> home sleep test. The Company accounts for its interest in NovaSom under the equity method.

First quarter of 2018

The Company funded an aggregate of \$1.3 million of convertible loans to NovaSom, Inc.

The Company funded an aggregate of \$0.8 million of convertible bridge loans to InfoBionic, Inc.

The Company funded an aggregate of \$0.5 million of convertible bridge loans to Spongecell, Inc. The Company had previously deployed an aggregate of \$18.6 million in Spongecell. In the first quarter of 2018, Spongecell merged into Flashtalking. The Company previously accounted for its interest in Spongecell under the equity method.

The Company funded an aggregate of \$0.5 million of convertible bridge loans to WebLinc, Inc.

The Company funded an aggregate of \$0.4 million of convertible bridge loans to Brickwork. The Company had previously deployed an aggregate of \$4.2 million in Brickwork. Brickwork helps retailers inform, target, convert, and prepare for store shoppers online as the first scalable software-as-a-service platform powering a seamless customer path between online and in-store shopping. The Company accounts for its interest in Brickwork under the equity method.

The Company funded an aggregate of \$0.3 million of convertible bridge loans to Cask Data, Inc.

The Company funded an aggregate of \$0.2 million of a convertible bridge loan to Sonobi, Inc.

4. Fair Value Measurements

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

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

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

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

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



## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table provides the carrying value and fair value of certain financial assets and liabilities of the Company measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017:

	Carrying Value	Fair Value Measurement at September 30, 2018		
		Level 1	Level 2	Level 3
(Unaudited - In thousands)				
Cash and cash equivalents	\$44,522	\$44,522	\$ —	\$ —
Trading securities	1,307	1,307	—	—
Marketable securities—held-to-maturity:				
Certificates of deposit	249	—	249	—
Government agency bond	\$8,471	\$8,471	\$ —	\$ —
U.S. Treasury Bills	\$16,394	\$16,394	\$ —	\$ —
Total marketable securities	\$25,114	\$24,865	\$ 249	\$ —

Credit facility repayment feature liability	\$5,622	\$—	\$ —	\$ 5,622
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	Carrying Value	Fair Value Measurement at December 31, 2017		
		Level 1	Level 2	Level 3
(Unaudited - In thousands)				
Cash and cash equivalents	\$20,751	\$20,751	\$ —	\$ —
Long-term restricted cash equivalents	6,336	6,336	—	—
Trading securities	3,761	3,761	—	—
Marketable securities—held-to-maturity:				
Certificates of deposit	\$4,452	\$4,452	\$ —	\$ —

As of September 30, 2018, \$25.1 million of marketable securities had contractual maturities which were less than one year. Held-to-maturity securities are carried at amortized cost, which, due to the short-term maturity of these instruments, approximates fair value using quoted prices in active markets for identical assets or liabilities defined as Level 1 inputs under the fair value hierarchy. As of September 30, 2018, \$5.6 million is recorded as a credit facility repayment feature liability, an increase of \$2.6 million from June 30, 2018, due to the provision in the Amended Credit Facility that requires prepayments of outstanding principal amounts when the Company's qualified cash at any quarter end date exceeds \$50.0 million. The prepayment feature is an embedded derivative that is accounted for as a liability separate from the Amended Credit Facility. The liability is adjusted to the fair value of potential future debt prepayments based upon management's probability weighted cash forecast at each balance sheet date. Management's cash forecasts are defined as Level 3 inputs under the fair value hierarchy.

Trading securities as of September 30, 2018 consisted of 78,103 shares of Invitae Corporation common shares released from escrow during the third quarter in connection with the sale of Good Start Genetics. Trading securities at December 31, 2017 consisted of 414,237 shares of Invitae Corporation common shares obtained in connection with the sale of Good Start Genetics. The trading securities were carried at fair value based on the closing stock price on the last trading day of the reporting period. The Company sold all of the initial Invitae shares that we held as of December 31, 2017 during the first quarter of 2018 for \$2.6 million of cash proceeds.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 5. Credit Facility and Convertible Debentures

## Credit Facility

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

In May 2018, the Company and Lender amended the Credit Facility (“Amended Credit Facility”) to increase the principal amount of indebtedness available to be borrowed by the Company from \$75.0 million to \$100.0 million. The maturity date and interest rate remained unchanged. The Amended Credit Facility consists of a term loan in the principal amount of \$85.0 million, (the “Term Loan”), \$50.0 million of which was outstanding prior to entering into the amendment and \$35.0 million of which was drawn in connection with the consummation of the amendment, and a revolving loan in the principal amount of up to \$15.0 million (the “Revolving Loan”). The Company may borrow and repay under the Revolving Loan at any time until its expiration on December 30, 2018. Any amounts outstanding under the Revolving Loan on December 30, 2018 will be subject to the same repayment terms as amounts borrowed under the Term Loan. Repayment terms under the Credit Facility include a make-whole interest provision equal to the interest that would have been payable had the principal amount subject to repayment been outstanding through the maturity date of the Credit Facility. Under the Amended Credit Facility, if the aggregate amount of the Company's qualified cash at any quarter end date exceeds \$50.0 million, the Company will be required to prepay outstanding principal amounts under the Amended Credit Facility, plus any applicable interest and prepayment fees, in an amount equal to 100% of such excess. Based on this requirement, the Company made a principal payment of \$16.4 million and a make-whole interest payment of \$2.8 million on October 15, 2018 based on the Company's qualified cash at September 30, 2018.

Certain debt covenants were revised in connection with the Amended Credit Facility. The Amended Credit Facility requires the Company to (i) maintain a liquidity threshold of at least \$20 million of unrestricted cash; (ii) maintain a minimum aggregate appraised value of the Company's ownership interests in its partner companies, plus unrestricted cash in excess of the liquidity threshold, of at least \$350 million less the aggregate amount of all prepayments of the Term Loan and all prepayments of the Revolving Loan made after December 30, 2018; (iii) limit deployments to only existing partner companies and such deployments may not exceed, when combined with deployments after January 1, 2018, \$40.0 million in the aggregate through the maturity date; and (iv) limit certain expenses (which shall exclude severance payments, interest expense, depreciation and stock-based compensation) incurred or paid to no more than \$11.5 million in any twelve-month period after the date of the amendment (or such shorter period as has elapsed since the date of the amendment). The Company is no longer required to maintain a specific net worth or any diversification requirements or concentration limits with respect to the Company's capital deployments to its partner companies. Additionally, under the Amended Credit Facility, the Company is restricted from repurchasing shares of its outstanding common stock and/or issuing dividends until such time as the Amended Credit Facility is repaid in full. As of the date these consolidated financial statements were issued, the Company was in compliance with all applicable covenants.

The \$35.0 million of additional principal that the Company borrowed with the consummation of the Amended Credit Facility resulted in net proceeds of \$32.7 million, after closing fees to the Lender and other third parties, that were

used towards the repayment of \$41.0 million of principal outstanding on its 2018 Debentures, which the Company repaid in full on the maturity date of May 15, 2018. There were no convertible debentures outstanding as of September 30, 2018.

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

At September 30, 2018, the principal amount outstanding under the Amended Credit Facility was \$85.0 million, the unamortized discount and debt issuance costs were \$5.2 million and the net carrying value of the credit facility was \$79.8 million. The Company accounted for the amendment to the Credit Facility as an insubstantial modification and is amortizing



## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the excess of the principal amount of the Amended Credit Facility over its carrying value over the remaining term as additional interest expense using a revised effective interest rate prospectively based on the revised cash flows. The Amended Credit Facility requires prepayments of outstanding principal amounts when the Company's qualified cash at any quarter end date exceeds \$50.0 million. This provision in the Amended Credit Facility is an embedded derivative that is accounted for separately from the credit facility. A liability of \$0.5 million was recorded on the amendment date for the fair value of potential future prepayments based upon management's probability weighted cash forecast. This amount is also included in debt issuance costs and will be amortized over the remaining term of the credit facility. The liability will be adjusted to fair value at each balance sheet date based upon management's updated probability weighted cash forecast. During the three and nine months ended September 30, 2018, the Company recorded losses of \$2.6 million and \$5.1 million, respectively, which is included in Other loss on the Consolidated Statements of Operations. The losses mainly relate to an increase in the fair value of the credit facility repayment feature liability due to an increase in the probability of debt prepayments caused by \$55.0 million of proceeds received in July 2018 in connection with the MediaMath and AdvantEdge Healthcare Solutions transactions. The Company recorded interest expense of \$3.3 million and \$1.7 million for the three months ended September 30, 2018 and 2017, respectively, and \$8.0 million and \$2.6 million for the nine months ended September 30, 2018 and 2017, respectively, under the Amended Credit Facility. The effective interest rate on the Amended Credit Facility is 14.9%. The Company made interest payments of \$2.4 million and \$1.2 million for the three months ended September 30, 2018 and 2017, respectively, and \$4.9 million and \$1.2 million for the nine months ended September 30, 2018 and 2017, respectively.

## Convertible Debentures

In November 2012, the Company issued \$55.0 million principal amount of its 5.25% convertible senior debentures due on May 15, 2018 (the "2018 Debentures"). Interest on the 2018 Debentures was payable semi-annually. In July and June 2017, the Company repurchased on the open market, and retired, an aggregate of \$14.0 million face value of the 2018 Debentures at a cost of \$14.5 million, including transaction fees. The Company repaid the remaining \$41.0 million of principal outstanding on its 2018 Debentures in full on the maturity date of May 15, 2018. The Company had no convertible debentures outstanding as of September 30, 2018. The Company had been amortizing the excess of the face value of the 2018 Debentures over their carrying value over their term as additional interest expense using the effective interest method and the Company recorded \$0.0 million and \$0.9 million of interest expense for the three months ended September 30, 2018 and 2017, respectively, and \$1.3 million and \$3.2 million for the nine months ended September 30, 2018 and 2017, respectively. The effective interest rate on the 2018 Debentures was 8.7%. The Company made no interest payments for the three months ended September 30, 2018 and 2017 and \$1.1 million and \$1.5 million for the nine months September 30, 2018 and 2017, respectively.

## 6. Stock-Based Compensation

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

	Three months ended September 30, 2018	Three months ended September 30, 2017	Nine months ended September 30, 2018	Nine months ended September 30, 2017
General and administrative expense	\$243	\$560	\$853	\$806
	\$243	\$560	\$853	\$806

The fair value of the Company's option awards to employees was estimated at the date of grant using the Black-Scholes option-pricing model. The risk-free rate was based on the U.S. Treasury yield curve in effect at the end

of the quarter in which the grant occurred. The expected term of stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility measured using weekly price observations of the Company's common stock for a period equal to the stock option's expected term.

#### 7. Income Taxes

The Company's consolidated income tax benefit (expense) was \$0.0 million for the three and nine months ended September 30, 2018 and 2017. The Company has recorded a valuation allowance to reduce its net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the benefit of the net operating loss that would have been recognized in the three and nine months ended September 30, 2018 was offset by changes in the valuation allowance. The tax expense that would have been recognized in the three and nine months ended September 30, 2018 was offset by changes in the valuation allowance. During the three and nine months ended September 30, 2018, the Company had no material changes in uncertain tax positions.

In December 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to: (i) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent; (ii) eliminating the corporate alternative

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

minimum tax (AMT) and changing how existing AMT credits can be realized; (iii) creating a new limitation on deductible interest expense; and (iv) changing rules related to uses and limitations of net operating carryforwards created in tax years beginning after December 31, 2017. The most significant impact on the Company's consolidated financial statements was a reduction of approximately \$82.5 million in deferred tax assets in 2017 which was offset by changes to the Company's valuation allowance.

## 8. Net Income (Loss) Per Share

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

	Three months ended September 30, 2018		Nine months ended September 30, 2017	
	(Unaudited - In thousands, except per share data)			
Basic:				
Net income (loss)	\$32,060	\$(18,650)	\$994	\$(69,844)
Weighted average common shares outstanding	20,561	20,455	20,535	20,416
Net income (loss) per share	\$1.56	\$(0.91)	\$0.05	\$(3.42)
Diluted:				
Net income (loss) for dilutive share computation	\$32,060	\$(18,650)	\$994	\$(69,844)
Number of shares used in basic per share computation	20,561	20,455	20,535	20,416
Unvested restricted stock and DSU's	—	—	—	—
Employee stock options	—	—	—	—
Weighted average common shares outstanding	20,561	20,455	20,535	20,416
Net income (loss) for dilutive share computation	\$1.56	\$(0.91)	\$0.05	\$(3.42)

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

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

Diluted earnings per share for the three and nine months ended September 30, 2018 and 2017 do not reflect the following potential shares of common stock that would have an anti-dilutive effect or have unsatisfied performance or market conditions:

- At September 30, 2018 and 2017, options to purchase 0.4 million and 0.6 million shares of common stock, respectively, at prices ranging from \$9.83 to \$19.95 for both periods, were excluded from the calculations.
- At September 30, 2018 and 2017, unvested restricted stock, performance-based stock units and DSUs convertible into 0.8 million and 0.9 million shares of stock, respectively, were excluded from the calculations.
- 1.1 million and 2.3 million shares of common stock that were outstanding during the period of 2018 and 2017, respectively, representing the effect of the assumed conversion of the 2018 Debentures, were excluded from the calculations.



## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 9. Segment Reporting

The Company operates as one operating segment based upon the similar nature of its technology-driven partner companies, the functional alignment of the organizational structure, and the reports that are regularly reviewed by the chief operating decision maker for the purpose of assessing performance and allocating resources. As of September 30, 2018, the Company held interests in 22 non-consolidated partner companies. The Company's active partner companies were as follows as of September 30, 2018:

Partner Company	Safeguard Primary Ownership as of September 30, 2018	Accounting Method
Aktana, Inc.	20.1%	Equity
Brickwork	20.3%	Equity
CloudMine, Inc.	47.3%	Equity
Clutch Holdings, Inc.	41.2%	Equity
Flashtalking <sup>1</sup>	10.3%	Other
Hoopla Software, Inc.	25.5%	Equity
InfoBionic, Inc.	25.4%	Equity
Lumesis, Inc.	43.8%	Equity
MediaMath, Inc. <sup>2</sup>	13.3%	Other
meQuilibrium	33.1%	Equity
Moxe Health Corporation	32.4%	Equity
NovaSom, Inc.	31.7%	Equity
Prognos (fka Medivo, Inc.)	28.7%	Equity
Propeller Health, Inc.	19.6%	Equity
QuanticMind, Inc.	24.7%	Equity
Sonobi, Inc.	21.6%	Equity
Syapse, Inc.	20.0%	Equity
T-REX Group, Inc.	21.1%	Equity
Transactis, Inc.	23.7%	Equity
Trice Medical, Inc.	23.4%	Equity
WebLinc, Inc.	37.9%	Equity
Zipnosis, Inc.	34.7%	Equity

<sup>1</sup> Spongecell, Inc. merged into Flashtalking in January 2018.

<sup>2</sup> The Company sold 39.1% of its ownership interest in MediaMath, Inc. back to the company for \$45.0 million of proceeds in July 2018.

As of September 30, 2018 and December 31, 2017, all of the Company's assets were located in the United States.

## SAFEGUARD SCIENTIFICS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 10. Commitments and Contingencies

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

The Company had outstanding guarantees of \$3.8 million at September 30, 2018 which related to one of the Company's private equity holdings.

The Company is required to return a portion or all the distributions it received as a general partner of a private equity fund for further distribution to such fund's limited partners ("clawback"). The Company's ownership in the fund is 19%. The clawback liability is joint and several, such that the Company may be required to fund the clawback for other general partners should they default. The Company believes its potential liability due to the possibility of default by other general partners is remote. In 2017, the Company was notified by the fund's manager that the fund was being dissolved and \$1.0 million of the Company's clawback liability was paid. The maximum additional clawback liability is \$0.3 million which was reflected in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2018.

In October 2001, the Company entered into an agreement with a former Chairman and Chief Executive Officer of the Company, to provide for annual payments of \$0.65 million per year and certain health care and other benefits for life. The related current liability of \$0.8 million was included in Accrued expenses and other current liabilities and the long-term portion of \$1.4 million was included in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2018.

The Company previously provided a \$6.3 million letter of credit to the landlord of CompuCom Systems, Inc.'s Dallas headquarters as required in connection with the sale of CompuCom Systems in 2004. The letter of credit was secured by cash and was classified as Long-term restricted cash equivalents on the Consolidated Balance Sheet as of December 31, 2017. During the first quarter of 2018, the restriction on the cash lapsed in connection with the termination of the related letter of credit.

In January 2018, the Company announced a change in strategy and implemented an initiative to reduce the operating costs of the Company. In April 2018, the Company announced additional management changes intended to further streamline the Company's organizational structure and further reduce its operating costs. In connection with the changes that the Company has implemented, the Company will incur approximately \$4.0 million of severance payments to terminated employees that will be paid during 2018 and 2019 and is being expensed over the remaining requisite service period. The Company recognized \$1.0 million and \$3.8 million of severance expense for the three and nine months ended September 30, 2018, respectively, which is included in General and Administrative expenses in the Consolidated Statement of Operations. The Company made severance payments of \$1.0 million and \$1.5 million for the three and nine months ended September 30, 2018, respectively, and \$2.3 million was classified as accrued compensation and benefits on the Consolidated Balance Sheet as of September 30, 2018.

The Company has agreements with certain remaining 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 employment and severance agreements for remaining employees was approximately \$5.4 million at September 30, 2018. In addition, in April 2018, the Board of Directors (the "Board") of the Company adopted a long-term incentive plan, the Safeguard Scientifics Transaction Bonus Plan, (the "LTIP"). The purpose of the LTIP is to promote the interests of the Company and its shareholders by providing an additional incentive to employees to maximize the value of the Company in connection with the execution of the business strategy that the Company adopted and announced in January 2018. Under the LTIP, participants may receive awards in connection with sales of the Company's partner company assets ("Sale Transaction(s)"). At the Board's sole discretion

following a sale of partner company assets, the Company may, but has no obligation to, provide a bonus pool under the LTIP based on a range of transaction consideration and subject to a minimum amount of transaction consideration. All current officers and employees of the Company are eligible to participate in the LTIP. The Board, in its sole discretion, will determine the participants to whom awards are granted under the LTIP, and the amounts of the awards relating to the bonus pool, if any. The Board has no obligation to grant any awards under the LTIP, even if transaction consideration exceeds the established minimum amount under the plan. There are no amounts payable under the LTIP as of September 30, 2018.

In June 2011, the Company's former partner company, Advanced BioHealing, Inc. ("ABH") was acquired by Shire plc ("Shire"). Prior to the expiration of the escrow period in March 2012, Shire filed a claim against all amounts held in escrow related to the sale based principally upon a United States Department of Justice ("DOJ") false claims act investigation relating to ABH (the "Investigation"). In connection with the Investigation, in July 2015 the Company received a Civil Investigation

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Demand-Documentary Material ("CID") from the DOJ regarding ABH and Safeguard's relationship with ABH. Pursuant to the CID, the Company provided the requested materials and information. To the Company's knowledge, the CID was related to multiple qui tam ("whistleblower") actions, one of which was filed in 2014 by an ex-employee of ABH that named the Company and one of the Company's employees along with other entities and individuals as defendants. At this time, the DOJ has declined to pursue the qui tam action as it relates to the Company and such Company employee. In addition, in connection with the above matters, the Company and other former equity holders in ABH entered into a settlement and release with Shire, which resulted in the release to Shire of all amounts held in escrow related to the sale of ABH.

#### 11. Equity

In July 2015, the Company's Board of Directors authorized the Company, from time to time and depending on market conditions, to repurchase up to \$25.0 million of the Company's outstanding common stock. During 2016, the Company repurchased 0.4 million shares at an aggregate cost of \$5.4 million with \$14.6 million remaining for repurchase under the existing authorization. Under the Amended Credit Facility, we are restricted from repurchasing shares of our outstanding common stock and/or issuing dividends until such time as the Amended Credit Facility is repaid in full.

In February 2018, the Company's Board of Directors adopted a tax benefits preservation plan (the "Plan") designed to protect and preserve the Company's ability to utilize its net operating loss carryforwards ("NOLs"). The Company submitted the Plan for shareholder ratification at its 2018 Annual Meeting of Shareholders and the Plan was ratified by shareholders. The purpose of the Plan is to preserve the Company's ability to use its NOLs, which would be substantially limited if the Company experienced an "ownership change" as defined under Section 382 of the Internal Revenue Code. In general, an ownership change would be deemed to have occurred if the Company's shareholders who are treated as owning five percent or more of the outstanding shares of Safeguard for purposes of Section 382 ("five-percent shareholders") collectively increase their aggregate ownership in the Company's overall shares outstanding by more than 50 percentage points. Whether this change has occurred would be measured by comparing each five-percent shareholder's current ownership as of the measurement date to such shareholders' lowest ownership percentage during the three-year period preceding the measurement date. To protect the Company's NOLs from being limited or permanently lost under Section 382, the Plan is intended to deter any person or group from acquiring beneficial ownership of 4.99% or more of the Company's outstanding common stock without the approval of the Board, reducing the likelihood of an unintended ownership change. Under the Plan, the Company will issue one preferred stock purchase right (the "Rights") for each share of Safeguard's common stock held by shareholders of record on March 2, 2018. The issuance of the Rights will not be taxable to Safeguard or its shareholders and will not affect Safeguard's reported earnings per share. The Rights will trade with Safeguard's common shares and will expire no later than February 19, 2021. The Rights and the Plan may also expire on an earlier date upon the occurrence of other events, including a determination by the Company's Board that the Plan is no longer necessary or desirable for the preservation of the Company's tax attributes or that no tax attributes may be carried forward (with such expiration occurring as of the beginning of the applicable taxable year). There can be no assurance that the Plan will prevent the Company from experiencing an ownership change.



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

### Cautionary Note Concerning Forward-Looking Statements

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

### Business Overview

Over the recent past, Safeguard has provided capital and relevant expertise to fuel the growth of technology-driven businesses in healthcare, financial services and digital media. Throughout this document and going forward, we will use the term "partner company" to generally refer to those companies in which we have a significant equity interest. In many, but not all cases, we will also be actively involved, influencing development through board representation and management support, in addition to the influence we exert through our equity ownership. From time to time, in addition to these partner companies, we also hold relatively small equity interests in other enterprises where we do not exert significant influence and do not participate in management activities. In some cases, these interests relate to former partner companies.

In January 2018, Safeguard announced that, from that date forward, we will not deploy any capital into new partner company opportunities and will focus on supporting our existing partner companies and maximizing monetization opportunities for partner company interests to enable distributions of net proceeds to shareholders. In that context, we will consider initiatives including, among others: the sale of individual partner companies, the sale of certain partner company interests in secondary market transactions, or a combination thereof, as well as other opportunities to maximize shareholder value. We anticipate distributing to shareholders net proceeds from the sale of partner companies or partner company interests, as applicable, after satisfying our debt obligations and working capital needs.

Safeguard's existing group of partner companies consist of technology-driven businesses in healthcare, financial services and digital media that are capitalizing on the next wave of enabling technologies with a particular focus on

the Internet of Everything, enhanced security and predictive analytics. We strive to create long-term value for our shareholders by helping our partner companies to increase their market penetration, grow revenue and improve cash flow.

#### Results of Operations

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

There is intense competition in the markets in which our partner companies operate. Additionally, the markets in which these companies operate are characterized by rapidly changing technology, evolving industry standards, frequent introduction of new products and services, shifting distribution channels, evolving government regulation, frequently changing intellectual property landscapes and changing customer demands. Their future success depends on each company's ability to execute its business plan and to adapt to its respective rapidly changing market. As previously stated, throughout this document, we use the term "partner company" to generally refer to those companies in which we have an economic interest and in which we, generally, but not all cases, are actively involved influencing development, usually through board representation in addition to our equity ownership. The following listing of our partner companies includes only entities which were considered partner companies as of September 30, 2018. Certain entities which may have been partner companies in previous periods are omitted if, as of September 30, 2018, they had been sold or are no longer considered a partner company.

Partner Company	Safeguard Primary Ownership as of		Accounting Method
	2018	2017	
Aktana, Inc.	20.1%	24.5%	Equity
Brickwork	20.3%	20.3%	Equity
CloudMine, Inc.	47.3%	47.4%	Equity
Clutch Holdings, Inc.	41.2%	42.7%	Equity
Flashtalking <sup>1</sup>	10.3%	NA	Other
Hoopla Software, Inc.	25.5%	25.5%	Equity
InfoBionic, Inc.	25.4%	39.5%	Equity
Lumesis, Inc.	43.8%	43.8%	Equity
MediaMath, Inc. <sup>2</sup>	13.3%	20.4%	Other
meQuilibrium	33.1%	37.0%	Equity
Moxe Health Corporation	32.4%	32.4%	Equity
NovaSom, Inc.	31.7%	31.7%	Equity
Prognos (fka Medivo, Inc.)	28.7%	35.2%	Equity
Propeller Health, Inc.	19.6%	24.0%	Equity
QuanticMind, Inc.	24.7%	24.7%	Equity
Sonobi, Inc.	21.6%	21.6%	Equity
Syapse, Inc.	20.0%	26.0%	Equity
T-REX Group, Inc.	21.1%	21.3%	Equity
Transactis, Inc.	23.7%	23.8%	Equity
Trice Medical, Inc.	23.4%	24.9%	Equity
WebLinc, Inc.	37.9%	38.0%	Equity
Zipnosis, Inc.	34.7%	25.4%	Equity

<sup>1</sup> Spongecell, Inc. merged into Flashtalking in January 2018.

<sup>2</sup> The Company sold 39.1% of its ownership interest in MediaMath, Inc. back to the company for \$45.0 million of proceeds in July 2018.

Three months ended September 30, 2018 versus the three months ended September 30, 2017

	Three months ended		
	September 30,		Variance
	2018	2017	
	(In thousands)		
General and administrative expense	\$(3,516 )	\$(3,758 )	\$242
Other loss	(1,078 )	(379 )	(699 )
Interest income	718	1,004	(286 )
Interest expense	(3,310 )	(2,643 )	(667 )
Equity income (loss)	39,246	(12,874 )	52,120
	\$32,060	\$(18,650)	\$50,710

**General and Administrative Expense.** Our general and administrative expenses consist primarily of employee compensation, severance, insurance, travel-related costs, depreciation, office rent and professional services such as consulting, legal, and accounting. General and administrative expense also includes stock-based compensation expense which consists primarily of expense related to grants of stock options, restricted stock and deferred stock units to our employees and directors. General and administrative expense decreased \$0.2 million for the three months ended September 30, 2018 compared to the prior year period due to a \$0.7 million decrease in employee compensation and related expenses due to employee terminations and operating cost reduction initiatives implemented earlier this year. Additionally, stock-based compensation decreased \$0.3 million for the three months ended September 30, 2018 compared to the prior year period. These decreases were partially offset by a \$1.0 million severance charge for employees who were terminated in connection with our change in strategy.

**Other Loss.** Other loss increased \$0.7 million for the three months ended September 30, 2018 compared to the prior year period. Other loss for the three months ended September 30, 2018 consists of a \$2.6 million loss related to an increase in the fair value of the amended credit facility repayment feature liability. This increase was partially offset by a \$1.4 million gain on the increase in the value of certain non-partner company equity securities based upon an observable price change. Additionally, there was an \$0.2 million increase for the three months ended September 30, 2018 in the fair value of escrow shares of Invitae Corporation common stock obtained in connection with the sale of Good Start Genetics in August 2017. Other income (loss) for the three months ended September 30, 2017 reflected a reflected a \$0.4 million decrease in the fair value of shares of Invitae Corporation common stock obtained in connection with the sale of Good Start Genetics.

**Interest Income.** Interest income includes all interest earned on available cash and marketable security balances as well as interest earned on notes receivable from our partner companies. The decrease of \$0.3 million for the three months ended September 30, 2018 compared to the prior year period was primarily attributable to lower average notes receivable from our partner companies.

**Interest Expense.** Interest expense is primarily related to our credit facility and convertible senior debentures. The increase of \$0.7 million for the three months ended September 30, 2018 compared to the prior year period was primarily attributable to an \$1.5 million increase of interest expense related to borrowings under the new credit facility we entered into in May 2017, partially offset by a \$0.9 million decrease in interest expense due to the \$41.0 million of convertible senior debentures were repaid in full on their maturity date in May 2018.

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

Equity income (loss) increased \$52.1 million for the three months ended September 30, 2018 compared to the prior year period. The components of equity loss for the three months ended September 30, 2018 and 2017 were as follows:



	Three months ended September 30,		
	2018	2017	Variance
	(In thousands)		
Gain on sale of partner interests	\$50,508	\$4,250	\$46,258
Unrealized dilution gain (loss) on the decrease of our percentage ownership in partner companies	3,579	(77)	3,656
Gain on proceeds received from escrow	1,134	—	1,134
Loss on impairment of partner companies	(4,757)	(206)	(4,551)
Share of loss of our equity method partner companies	(11,218)	(16,841)	5,623
	\$39,246	\$(12,874)	\$52,120

The gain on sale of partner interests for the three months ended September 30, 2018 is comprised of MediaMath of \$45.0 million and AdvantEdge Healthcare Solutions of \$5.5 million. For the three months ended September 30, 2017, the Gain on sale of partner interests is comprised of Good Start Genetics for \$4.3 million.

The gain on proceeds received from escrow for the three months ended September 30, 2018 is comprised of a \$1.1 million gain related to the Invitae shares released from escrow in connection with the Good Start Genetics sale.

The loss on impairment of partner companies for the three months ended September 30, 2018 is comprised of CloudMine of \$4.8 million. For the three months ended September 30, 2017, the loss on impairment of partner companies is comprised of Pneuron for \$0.2 million.

The change in our share of equity loss of our equity method partner companies for the three months ended September 30, 2018 compared to the prior year period was primarily due to an decrease in the number of partner companies and losses associated with those partner companies.

Nine months ended September 30, 2018 versus the nine months ended September 30, 2017

	Nine months ended September 30,		
	2018	2017	Variance
	(In thousands)		
General and administrative expense	\$(14,253)	\$(13,191)	\$(1,062)
Other loss	(4,965)	(219)	(4,746)
Interest income	2,182	2,892	(710)
Interest expense	(9,422)	(5,953)	(3,469)
Equity income (loss)	27,452	(53,373)	80,825
	\$994	\$(69,844)	\$70,838

General and Administrative Expense. General and administrative expense increased \$1.1 million for the nine months ended September 30, 2018, compared to the prior year period, primarily due to a \$3.8 million severance charge for employees who were terminated in connection with our change in strategy. Additionally, professional fees increased \$1.6 million for the nine months ended September 30, 2018, compared to the prior year period, primarily due to costs associated with activist shareholder matters. These increases were partially offset by a \$3.5 million decrease in employee compensation and related expenses due to employee terminations and operating cost reduction initiatives implemented earlier this year and a decrease of \$0.8 million for various other general administrative expenses.

Other Loss. Other loss decreased \$4.7 million for the nine months ended September 30, 2018 compared to the prior year period. Other loss for the nine months ended September 30, 2018 included a \$5.1 million loss related to an increase in the fair value of the amended credit facility repayment feature liability and a \$1.0 million decrease in the fair value of shares of Invitae Corporation common stock obtained in connection with the sale of Good Start Genetics in August 2017. The decreases for the nine months ended September 30, 2018 are partially offset by a \$1.4 million gain on the increase in the value of certain non-partner company equity securities based upon an observable price change. Other loss for the nine months ended September 30, 2017 reflected a \$0.4 million decrease in the fair value of shares of Invitae Corporation common stock obtained in connection with the sale of Good Start Genetics in August 2017 and an impairment of \$0.2 million related to our interest in a legacy private equity fund, partially offset by a \$0.4 million gain related to our Penn Mezzanine debt and equity participations.

Interest Income. Interest income decreased \$0.7 million for the nine months ended September 30, 2018 compared to the prior year period was primarily attributable to lower average notes receivable from our partner companies.

Interest Expense. Interest expense increased \$3.5 million for the nine months ended September 30, 2018 compared to the prior year period primarily due to a \$5.3 million increase in interest expense related to borrowings under the credit facility we entered into in May 2017, partially offset by a \$1.9 million decrease in interest expense associated with the convertible senior debentures that were repaid in full on their maturity date in May 2018.

Equity Income (Loss). Equity income (loss) decreased \$80.8 million for the nine months ended September 30, 2018 compared to the prior year period. The components of equity income (loss) for the nine months ended September 30, 2018 and 2017 were as follows:

	Nine months ended September 30,		
	2018	2017	Variance
	(In thousands)		
Gain on sale of partner interests	\$64,172	\$4,358	\$59,814
Unrealized dilution gain (loss) on the decrease of our percentage ownership in partner companies	6,660	(1,006 )	7,666
Gain on Spongecell's merger into Flashtalking	3,808	—	3,808
Gains on proceeds received from escrow	1,838	1,445	393
Loss on impairment of partner companies	(11,324 )	(8,739 )	(2,585 )
Share of loss of our equity method partner companies	(37,702 )	(49,431 )	11,729
	\$27,452	\$(53,373)	\$80,825

The gain on sale of partner interests for the nine months ended September 30, 2018 is comprised of MediaMath of \$45.0 million, Nexxt (fka Beyond.com) of \$9.5 million, AdvantEdge Healthcare Solutions of \$5.5 million and Cask Data of \$4.2 million. For the nine months ended September 30, 2017, the Gain on sale of partner interests is comprised of Good Start Genetics for \$4.3 million and Nexxt (fka Beyond.com) for \$0.1 million.

The gain on proceeds received from escrow for the nine months ended September 30, 2018 is comprised of a \$1.1 million gain related to the Invitae shares released from escrow in connection with the Good Start Genetics sale and a \$0.7 million gain related to the sale of Aventura and Pneuron assets. For the nine months ended September 30, 2017, the gain on proceeds received from escrow is comprised of Putney of \$0.7 million, Quantia of \$0.6 million, and AppFirst of \$0.1 million.

The loss on impairment of partner companies for the nine months ended September 30, 2018 is comprised of Apprenda of \$6.6 million and CloudMine of \$4.8 million. For the nine months ended September 30, 2017, the loss on impairment of partner companies is comprised of Spongecell of \$3.5 million and Pneuron of \$5.2 million.

The change in our share of equity loss of our equity method partner companies for the nine months ended September 30, 2018 compared to the prior year period was due to a decrease in the number of partner companies and a decrease in losses associated with our partner companies.

#### Income Tax Benefit (Expense)

Income tax benefit (expense) was \$0.0 million for the three and nine months ended September 30, 2018 and 2017. We have recorded a valuation allowance to reduce our net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the benefit of the net operating loss that would have been recognized in the three and nine months ended September 30, 2018 and 2017 was offset by changes in the valuation allowance.

#### Liquidity and Capital Resources

As of September 30, 2018, we had \$44.5 million of cash and cash equivalents and \$25.1 million of marketable securities for a total of \$69.6 million. As of September 30, 2018, we had \$85.0 million of principal outstanding on our Amended Credit Facility due in May 2020. We currently have \$15.0 million of availability under the Amended Credit Facility.

In January 2018, Safeguard announced that, from that date forward, we will not deploy any capital into new partner company opportunities and will focus on supporting our existing partner companies and maximizing monetization opportunities for partner company interests to enable distributions of net proceeds to shareholders. In that context, we will consider initiatives including, among others: the sale of individual partner companies, the sale of certain partner company interests in secondary market transactions, or a combination thereof, as well as other opportunities to maximize shareholder value. We anticipate distributing to shareholders net proceeds from the sale of partner



companies or partner company interests, as applicable, after satisfying our debt obligations and working capital needs. In connection with our change in strategy, in January 2018, we implemented an initiative to reduce our operating costs. In April 2018, we announced additional management changes intended to further streamline our organizational structure and further reduce our operating costs. In connection with the changes that we

have implemented, we will incur approximately \$4.0 million of severance payments to terminated employees that will be paid over approximately twelve months. We anticipate that with these organizational changes and cost reduction initiatives, our ongoing annualized operating expenses excluding interest, depreciation, severance and stock-based compensation, will approximate \$8 million to \$9 million. The maximum aggregate exposure under employment and severance agreements for remaining employees was approximately \$5.4 million at September 30, 2018.

In May 2017, we entered into a \$75.0 million secured, revolving credit facility ("Credit Facility") with HPS Investment Partners, LLC ("Lender"). In May 2018, we amended the Credit Facility ("Amended Credit Facility") to increase the principal amount of indebtedness available to be borrowed by us from \$75.0 million to \$100.0 million. The interest rate and maturity date of May 2020 remained unchanged. The Amended Credit Facility consists of a term loan in the principal amount of \$85.0 million, (the "Term Loan"), \$50.0 million of which was outstanding prior to entering into the amendment and \$35.0 million of which was drawn in connection with the consummation of the amendment, and a revolving loan in the principal amount of up to \$15.0 million (the "Revolving Loan"). We may borrow and repay under the Revolving Loan at any time until its expiration on December 30, 2018. Any amounts outstanding under the Revolving Loan on December 30, 2018 will be subject to the same repayment terms as amounts borrowed under the Term Loan. Repayment terms under the Amended Credit Facility include a make-whole interest provision equal to the interest that would have been payable had the principal amount subject to repayment been outstanding through the maturity date of the Amended Credit Facility. Under the Amended Credit Facility, if the aggregate amount of our qualified cash at any quarter end date exceeds \$50.0 million, we will be required to prepay outstanding principal amounts under the Amended Credit Facility, plus any applicable interest and prepayment fees, in an amount equal to 100% of such excess. Based on this requirement, the Company made a principal payment of \$16.4 million and a make-whole interest payment of \$2.8 million on October 15, 2018 based on the Company's qualified cash at September 30, 2018.

Certain debt covenants were revised in connection with the Amended Credit Facility. The Amended Credit Facility requires us to (i) maintain a liquidity threshold of at least \$20 million of unrestricted cash; (ii) maintain a minimum aggregate appraised value of our ownership interests in our partner companies, plus unrestricted cash in excess of the liquidity threshold, of at least \$350 million less the aggregate amount of all prepayments of the Term Loan and all prepayments of the Revolving Loan made after December 30, 2018; (iii) limit deployments to only existing partner companies and such deployments may not exceed, when combined with deployments after January 1, 2018, \$40.0 million in the aggregate through the maturity date; and (iv) limit certain expenses (which shall exclude severance payments, interest expense, depreciation and stock-based compensation) incurred or paid to no more than \$11.5 million in any twelve-month period after the date of the amendment (or such shorter period as has elapsed since the date of the amendment). We are no longer required to maintain a specific net worth or any diversification requirements or concentration limits with respect to our capital deployments to our partner companies. Additionally, under the Amended Credit Facility, we are restricted from repurchasing shares of our outstanding common stock and/or issuing dividends until such time as the Amended Credit Facility is repaid in full. As of the date these consolidated financial statements were issued, we were in compliance with all applicable covenants.

The \$35.0 million of additional principal that we borrowed with the consummation of the Amended Credit Facility resulted in net proceeds of \$32.7 million, after closing fees to the Lender and other third parties, that was used towards the repayment of \$41.0 million of principal outstanding on our 2018 Debentures, which we repaid in full on the maturity date of May 15, 2018. There were no convertible debentures outstanding as of September 30, 2018.

We fund our operations with cash and marketable securities on hand as well as proceeds from the sales of our interests in our partner companies. Due to the nature of the mergers and acquisitions market, and the developmental cycle of companies like our partner companies, our ability to generate specific amounts of liquidity from sales of our partner company interests in any given period of time cannot be assured. Accordingly, the forecasts which we utilize for projecting future compliance with covenants related to our Credit Facility include significantly discounted probability-weighted proceeds from the sales of our interests in our partner companies. Based on these forecasts, we believe we will remain in compliance with all of our debt covenants. Non-compliance with any of the covenants would constitute an event of default under the Credit Facility, and the Lender could choose to accelerate the maturity of the indebtedness. If the Lender chose not to provide a waiver and were to accelerate the maturity of the indebtedness, we may not have sufficient liquidity to repay the entire balance of our outstanding borrowings and other

obligations under the Credit Facility.

In order for us to maintain compliance with these covenants, our plan includes selling certain of our partner company interests in the ordinary course of our business and limiting capital deployments to existing partner companies, if necessary. Should we not be in compliance with any of our debt covenants and be unable to obtain waivers for such events of default, management would pursue one of a number of potential alternatives to satisfy the obligations, including completing an equity offering or obtaining a new debt facility to refinance our existing debt.

We previously provided a \$6.3 million letter of credit to the landlord of CompuCom Systems, Inc.'s Dallas headquarters as required in connection with the sale of CompuCom Systems in 2004. The letter of credit was secured by cash and was

classified as Long-term restricted cash equivalents on the Consolidated Balance Sheet as of December 31, 2017. During the first quarter of 2018, the restriction on the cash lapsed in connection with the termination of the related letter of credit.

In July 2015, the Company's Board of Directors authorized us, from time to time and depending on market conditions, to repurchase up to \$25.0 million of the Company's outstanding common stock. During the year ended December 31, 2016, we repurchased 0.4 million shares at an aggregate cost of \$5.4 million with \$14.6 million remaining for repurchase under the existing authorization. Under the Amended Credit Facility, we are restricted from repurchasing shares of our outstanding common stock and/or issuing dividends until such time as the Amended Credit Facility is repaid in full.

We are required to return a portion or all the distributions we received as a general partner of a private equity fund for further distribution to such fund's limited partners ("clawback"). Our ownership in the fund is 19%. The clawback liability is joint and several, such that we may be required to fund the clawback for other general partners should they default. We believe our potential liability due to the possibility of default by other general partners is remote. In 2017, we were notified by the fund's manager that the fund was being dissolved and \$1.0 million of our clawback liability was paid. The maximum additional clawback liability is \$0.3 million which was reflected in Other long-term liabilities on the Consolidated Balance Sheet at September 30, 2018.

Our ability to generate liquidity from sales of partner companies, sales of marketable securities and from equity and debt issuances has been adversely affected from time to time by adverse circumstances in the U.S. capital markets and other factors. The transactions we enter into in pursuit of our strategy could increase or decrease our liquidity at any point in time. As we seek to provide additional funding to existing partner companies or commit capital to other initiatives, we may be required to expend our cash or incur debt, which will decrease our liquidity. Conversely, as we dispose of our interests in partner companies from time to time, we may receive proceeds from such sales, which could increase our liquidity. From time to time, we are engaged in discussions concerning acquisitions and dispositions which, if consummated, could impact our liquidity, perhaps significantly. The Company believes that its cash, cash equivalents and marketable securities at September 30, 2018 will be sufficient to fund operations past one year from the issuance of these financial statements.

#### Analysis of Consolidated Cash Flows

Cash flow activity was as follows:

	Nine months ended September 30,		
	2018	2017	Variance
	(In thousands)		
Net cash used in operating activities	\$(18,649)	\$(15,515)	\$(3,134)
Net cash provided by (used in) investing activities	44,570	(1,912)	46,482
Net cash provided by (used in) financing activities	(8,486)	29,686	(38,172)
	\$17,435	\$12,259	\$5,176

#### Net Cash Used In Operating Activities

Net cash used in operating activities increased by \$3.1 million for the nine months ended September 30, 2018 compared to the prior year period. The increase was primarily due to an increase of \$3.7 million of cash interest payments related to our credit facility we entered into in May 2017, partially offset by a \$0.5 million decrease cash interest payments related to the convertible senior debentures that were repaid in full on their maturity date in May 2018.

#### Net Cash Provided by (used in) Investing Activities

Net cash provided by (used in) investing activities increased by \$46.5 million for the nine months ended September 30, 2018 compared to the prior year period. The increase primarily related to a \$53.3 increase in proceeds from sales of and distributions from companies, a \$10.5 million repayment of principal outstanding on a note from Nexxt, Inc., a \$8.6 million decrease in acquisitions of ownership interests in companies and a \$4.8 million decrease in advances and loans to companies, partially offset by the \$31.0 million decrease in cash proceeds from the net change in marketable securities.

Cash proceeds from the sales of and distributions from companies were \$69.9 million for the nine months ended September 30, 2018 which related primarily to:

• In July 2018, we sold 39.13% of our ownership interest in MediaMath back to MediaMath and received \$45.0 million of proceeds from the partial sale.

• In July 2018, we received \$10.0 million of proceeds from the sale of our interest in AdvantEdge Healthcare Solutions, Inc.

In May 2018, we received \$11.5 million of proceeds from the sale of substantially all of the assets of Cask Data, Inc. In February 2018, we sold 414,237 shares of Invitae Corporation ("Invitae") common stock on the open market for proceeds of \$2.6 million after transaction fees. The shares of Invitae were obtained in August 2017 when Invitae, a public company, acquired former partner company Good Start Genetics, Inc.

In January 2018, we received \$0.6 million of proceeds from the sale of the assets of Aventura, Inc., a former partner company that ceased operations and was fully impaired in 2016.

Cash proceeds from the sales of and distributions from partner companies was \$16.6 million for the nine months ended September 30, 2017 which related primarily to proceeds from the sale of our interest in partner company Nexxt, Inc., formerly Beyond.com, back to Nexxt, Inc. for \$26.0 million. We received \$15.5 million in cash in March 2017 and a three-year, \$10.5 million note, that was repaid during the three months ended March 31, 2018.

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

Net cash provided by (used in) financing activities decreased by \$38.2 million for the nine months ended September 30, 2018 compared to the prior year period. The primary financing activities in 2018 were the repayment of \$41.0 million of our 2018 Debentures on their maturity date of May 15, 2018 and \$32.7 million of net proceeds from additional borrowings under our Amended Credit Facility. The primary financing activities in 2017 were net proceeds of \$44.3 million from borrowing under the credit facility we entered into in May 2017 and \$14.5 million paid to repurchase and retire \$14.0 million face value of the 2018 Debentures, including transaction fees.

#### Contractual Cash Obligations and Other Commercial Commitments

The following table summarizes our contractual obligations and other commercial commitments as of September 30, 2018, by period due or expiration of the commitment.

	Payments Due by Period				
	Total	2018 (remainder)	2019 and 2020	2021 and 2022	After 2022
(In millions)					
Contractual Cash Obligations:					
Credit facility	85.0	16.4	68.6	—	—
Interest payments on debt	15.2	3.8	11.4	—	—
Operating leases (a)	4.5	0.1	1.2	1.2	2.0
Potential clawback liabilities (b)	0.3	—	0.3	—	—
Other long-term obligations (c)	2.3	0.2	1.6	0.5	—
<b>Total Contractual Cash Obligations</b>	<b>\$107.3</b>	<b>\$ 20.5</b>	<b>\$ 83.1</b>	<b>\$ 1.7</b>	<b>\$ 2.0</b>

(a) In 2015, we entered into an agreement for the lease of our principal executive offices which expires in April 2026.

We are required to return a portion or all the distributions we received as a general partner of a private equity fund for further distribution to such fund's limited partners ("clawback"). Our ownership in the fund is 19%. The clawback liability is joint and several, such that we may be required to fund the clawback for other general partners should

(b) they default. We believe our potential liability due to the possibility of default by other general partners is remote.

We were notified by the fund's manager that the fund is being dissolved and \$1.0 million of our clawback liability was paid in the first quarter of 2017. The maximum clawback liability is \$0.3 million which was reflected in Other long-term liabilities on the Consolidated Balance Sheets at September 30, 2018.

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

### Factors That May Affect Future Results

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

The intended monetization of our partner company interests and distribution of net proceeds to shareholders are subject to factors beyond our control.

In January 2018, we announced that we will not deploy any capital into new partner companies. We will instead focus on supporting, and maximizing monetization opportunities for our existing partner company interests to enable distributions of net proceeds to shareholders. However, this strategic plan may require providing significant additional capital and operational support to such existing partner companies and we may not be able to sell our partner company interests during any specific time frame or otherwise on desirable terms, if at all, and there can be no assurance as to how long this process will take or the results that this process will yield. There can be no assurance as to whether we will realize the value of escrowed proceeds, holdbacks or other contingent consideration, if any, associated with the sale of partner company interests. Additionally, there can be no assurance that we will be able to satisfy our liabilities during this process. Further, the method, timing and amount of any distributions resulting from the monetization of existing partner companies will be at the discretion of our Board of Directors and will depend on market and business conditions and our overall liabilities, capital structure and liquidity position.

The continuing costs and burdens associated with being a public company will constitute a much larger percentage of our expenses and we may in the future delist our Common Stock with the New York Stock Exchange and seek to deregister our Common Stock with the SEC.

We will remain a public company and will continue to be subject to the listing standards of the New York Stock Exchange and SEC rules and regulations, including the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Sarbanes-Oxley Act of 2002. The costs and burdens of being a public company will be a significant and continually increasing portion of our expenses if we are able to monetize partner company interests. As part of such monetization efforts, we will likely in the future, once the majority of our partner company interests have been monetized and proceeds therefrom distributed, delist our Common Stock from the New York Stock Exchange and seek to deregister our Common Stock with the SEC. However, there can be no assurance as to the timing of such transactions, or whether such transactions will be completed at all, and we will continue to face the costs and burdens of being a public company until such time as our Common Stock is delisted with the New York Stock Exchange and deregistered with the SEC.

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

If we make poor decisions regarding the deployment of capital into, and subsequent disposition of, existing partner companies, our business strategy will not succeed. If our partner companies do not succeed, the value of our assets could be significantly reduced and require substantial impairments or write-offs and our results of operations and the price of our common stock would be adversely affected. The risks relating to our partner companies include:

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

- the inability to attract and retain qualified personnel;
- the existence of government regulations and legal uncertainties may place financial burdens on the businesses of our partner companies; and
- the inability to plan for and manage catastrophic events.

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



Our Credit Facility subjects us to interest rate risk.

In May 2017, we entered into a \$75.0 million secured, revolving credit facility with HPS Investment Partners, LLC (“Lender”), which was amended in May 2018 to increase the principal amount of indebtedness available to be borrowed by the Company from \$75.0 million to \$100.0 million (as amended, the “Credit Facility”). Debt service costs under the Credit Facility are subject to interest rate changes. Interest rates could rise from time to time and significantly increase our cost of borrowing. If that were to occur, replacing the Credit Facility with alternative credit arrangements having a lower cost of borrowing would likely not be possible and no assurance can be given that we would be able to refinance the Credit Facility on attractive terms or at all.

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

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

Covenants in the agreements governing the Credit Facility could adversely affect our business and/or result in the operation of our business in a way other than as desired by management; our ability to comply with such covenants may be affected by events beyond our control; and a breach of any of these covenants could result in a default under the agreements governing the Credit Facility, which, if not cured or waived, could result in the acceleration of the indebtedness under the Credit Facility.

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

- Sell, transfer, lease, convey or otherwise dispose of all or any part of our business or property;
- Make deployments to companies other than our existing partner companies;
- Make deployments that, when combined with deployments after January 1, 2018, exceed \$40.0 million in the aggregate;
- Following May, 2018, incur or pay for any expenses in any twelve-month period in excess of \$11.5 million;
- Incur or assume liens or additional debt or provide guarantees in respect of obligations of other persons;
- Pay any dividends or make any distribution (in cash or in kind) or payment in respect of, or redeem, retire or purchase any capital stock;
- Enter into, or permit any of our subsidiaries to enter into, any sale and leaseback transaction;
- Wind-up, liquidate or dissolve, or merge, consolidate or amalgamate with any person, or permit any of our subsidiaries to do (or agree to do) so;
- Enter into certain transactions with affiliates; and
- Amend, modify or otherwise change any of our governing documents.

In addition, the Credit Facility requires us to among other things, maintain (i) a liquidity threshold of at least \$20 million of unrestricted cash; and (ii) a minimum aggregate appraised value of the Company’s ownership interests in its partner companies, plus unrestricted cash in excess of the liquidity threshold, of at least \$350 million less certain prepayments made under the Credit Facility.

The foregoing covenants could adversely affect our ability to finance our operations, engage in business activities that may be in our interest and plan for or react to market conditions or otherwise execute our business strategies.

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

Our failure to comply with any of these covenants could result in a default under the Credit Facility. If that were to occur, the Lender could choose to accelerate the maturity of the indebtedness. If the Lender were to accelerate the

maturity of the indebtedness, we may not have sufficient liquidity to repay the entire balance of the outstanding borrowings and other obligations under the Credit Facility.

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

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

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

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

From time to time, we may hold equity interests in companies that are publicly traded. Fluctuations in the market prices of the common stock of publicly traded holdings may affect the price of our common stock. Historically, the market prices of our publicly traded holdings have been highly volatile and subject to fluctuations unrelated or disproportionate to operating performance.

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

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

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

Our success is dependent on our senior management.

Our success is dependent on our senior management team's ability to execute our strategy. On April 6, 2018, we publicly announced a series of management changes intended to streamline our organizational structure and reduce our operating costs. These aggressive cost-reduction initiatives are intended to better align our cost structure with the strategy we announced in January 2018 to reduce our operating costs, monetize our Partner Company interests and maximize the net proceeds distributable to our shareholders. These management changes included the departure, or change in role and planned departure,

of three members of our management team, including our then President and Chief Executive Officer, our then Senior Vice President and Chief Financial Officer, and our current Senior Vice President of Investor Relations and Corporate Communications. A loss of one or more of the remaining members of our senior management team without adequate replacement could have a material adverse effect on us.

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

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

the market value of our partner companies to decline. If valuations in the market sectors in which our partner companies participate decline, their access to the public and private capital markets on terms acceptable to them may be limited.

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

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

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

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

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

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

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

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

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

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

Economic disruptions and downturns may have negative repercussions for us.

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

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

We cannot assure you that material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in a material weakness, or could result in material misstatements in our

Consolidated Financial Statements. These misstatements could result in a restatement of our Consolidated Financial Statements, cause us to fail to meet our reporting obligations and/or cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

### Risks Related to Our Partner Companies

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

Most of our partner companies have a history of operating losses and/or limited operating history, have significant historical losses and may never be profitable. Many have incurred substantial costs to develop and market their products, have incurred net losses and cannot fund their cash needs from operations. We expect that the operating expenses of certain of our partner companies will increase substantially in the foreseeable future as they continue to develop products and services, increase sales and marketing efforts, and expand operations.

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

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

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

Our partner companies' business strategies are often highly dependent upon the successful launch and commercialization of an innovative technology or device, including, without limitation, technologies or devices used in healthcare, financial services or digital media. Despite all of our efforts to understand the research and development underlying the innovation or creation of such technologies and devices before we deploy capital into a partner company, sometimes the performance of the technology or device does not match our expectations or those of our partner company. In those situations, it is likely that we will incur a partial or total loss of the capital which we deployed in such partner company.

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

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

The technology marketplaces are characterized by:

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

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

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

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

- improve, upgrade and expand their business infrastructures;
- scale up production operations;
- develop appropriate financial reporting controls;



- attract and retain qualified personnel; and
- maintain appropriate levels of liquidity.

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

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

We cannot be certain that our partner companies will be able to obtain additional financing on favorable terms when needed, if at all. Because our resources and our ability to raise capital are not unlimited, we may not be able to provide partner companies with sufficient capital resources to enable them to reach a cash-flow positive position or a sale of the company, even if we wish to do so. General economic disruptions and downturns may also negatively affect the ability of some of our partner companies to fund their operations from other stockholders and capital sources. We also may fail to accurately project the capital needs of partner companies. If partner companies need capital but are not able to raise capital from us or other outside sources, then they may need to cease or scale back operations. In such event, our interest in any such partner company will become less valuable. If our partner companies raise additional capital, either debt or equity, that ranks senior to the capital we have deployed, such capital may entitle its holders to receive returns of capital before the dates on which we are entitled to receive any return of our deployed capital. Also, in the event of any insolvency, liquidation, dissolution, reorganization or bankruptcy of a partner company, holders of such partner company's instruments that rank senior to our deployed capital will typically be entitled to receive payment in full before we receive any return of our deployed capital. After returning such senior capital, such partner company may not have any remaining assets to use for returning capital to us, causing us to lose some or all of our deployed capital in such partner company.

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

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

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

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

Some of our partner companies also license intellectual property from third parties and it is possible that they could become subject to infringement actions based upon their use of the intellectual property licensed from those third parties. Our partner companies generally obtain representations as to the origin and ownership of such licensed intellectual property. However, this may not adequately protect them. Any claims against our partner companies' proprietary rights, with or without merit, could subject the companies to costly litigation and divert their technical and

management personnel from other business concerns. If our partner companies incur costly litigation and their personnel are not effectively deployed, the expenses and losses incurred by our partner companies will increase and their profits, if any, will decrease.

Third parties have and may assert infringement or other intellectual property claims against our partner companies based on their patents or other intellectual property claims. Even though we believe our partner companies' products do not infringe any third party's patents, they may have to pay substantial damages, possibly including treble damages, if it is ultimately determined that they do. They may have to obtain a license to sell their products if it is determined that their products infringe

on another person's intellectual property. Our partner companies might be prohibited from selling their products before they obtain a license, which, if available at all, may require them to pay substantial royalties. Even if infringement claims against our partner companies are without merit, defending these types of lawsuits takes significant time, is expensive and may divert management attention from other business concerns.

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

Because manufacture and sale of certain partner company products entail an inherent risk of product liability, certain partner companies maintain product liability insurance. Although none of our current partner companies have experienced any material losses in this regard, there can be no assurance that they will be able to maintain or acquire adequate product liability insurance in the future and any product liability claim could have a material adverse effect on a partner company's financial stability, revenues and results of operations. In addition, many of the engagements of our partner companies involve projects that are critical to the operation of their clients' businesses. If our partner companies fail to meet their contractual obligations, they could be subject to legal liability, which could adversely affect their business, operating results and financial condition. Partner company contracts typically include provisions designed to limit their exposure to legal claims relating to their services and products. However, these provisions may not protect our partner companies or may not be enforceable. Also, some of our partner companies depend on their relationships with their clients and their reputation for high-quality services and integrity to retain and attract clients. As a result, claims made against our partner companies' work may damage their reputation, which in turn could impact their ability to compete for new work and negatively impact their revenue and profitability.

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

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

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

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

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

Some of our partner companies may be subject to licensing and regulation under federal, state and local laws and regulations relating to the protection of the environment and human health and safety, including laws and regulations relating to the handling, transportation and disposal of medical specimens, infectious and hazardous waste and radioactive materials, as well as to the safety and health of manufacturing and laboratory employees. In addition, the federal Occupational Safety and Health Administration has established extensive requirements relating to workplace safety. Compliance with such regulations could increase operating costs at certain of our partner companies, and the failure to comply could negatively affect the operations and results of some of our partner companies.

Catastrophic events may disrupt our partner companies' businesses.

Some of our partner companies are highly automated businesses and rely on their network infrastructure, various software applications and many internal technology systems and data networks for their customer support, development, sales and marketing and accounting and finance functions. Further, some of our partner companies provide services to their customers from data center facilities in multiple locations. Some of these data centers are operated by third parties, and the partner companies have limited control over those facilities. A disruption or failure of these systems or data centers in the event of a natural disaster, telecommunications failure, power outage, cyber-attack, war, terrorist attack or other catastrophic event could cause system interruptions, reputational harm, delays in product development, breaches of data security and loss of

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

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

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

There have been no material changes to the information we previously disclosed under Item 7A of Part II of our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on March 7, 2018.

#### Item 4. Controls and Procedures

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of September 30, 2018 are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

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

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

## PART II

### OTHER INFORMATION

#### Item 1. Legal Proceedings

None.

#### Item 1A. Risk Factors

Except as included under the heading "Factors That May Affect Future Results" above, there have been no material changes in our risk factors from the information set forth in our Annual Report on Form 10-K for the year ended December 31, 2017.

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

The following table provides information about purchases of equity securities by the Company and affiliated purchasers of the Company, during the quarter ended September 30, 2018, which equity securities are registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"):

Period	Total Number of Shares Purchased (a)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan (b)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan (b)
July 1, 2018 - July 31, 2018	193	\$12.7250	—	\$ 14,636,135
August 1, 2018 - August 31, 2018	—	\$—	—	\$ 14,636,135
September 1, 2018 - September 30, 2018	3,139	\$10.0000	—	\$ 14,636,135
Total	3,332	\$10.1578	—	

(a) During the third quarter of 2018, the Company repurchased an aggregate of 3 thousand shares of its common stock initially issued as restricted stock awards to employees and subsequently withheld from employees to satisfy the statutory withholding tax liability upon the vesting of such restricted stock awards.

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

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.

## Item 6. Exhibits

## (a) Exhibits.

The following is a list of exhibits required by Item 601 of Regulation S-K to be filed as part of this Report. For exhibits that previously have been filed, the Registrant incorporates those exhibits herein by reference. Documents which are incorporated by reference to filings by parties other than the Registrant are identified in a footnote to this table.

Exhibit Number	Description
31.1 †	<u>Certification of Brian J. Sisko pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934.</u>
31.2 †	<u>Certification of Mark A. Herndon pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934.</u>
32.1 ‡	<u>Certification of Brian J. Sisko pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2 ‡	<u>Certification of Mark A. Herndon pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101	The following materials from Safeguard Scientifics, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets (unaudited); (ii) Consolidated Statements of Operations (unaudited); (iii) Consolidated Statements of Comprehensive Income (Loss) (unaudited); (iv) Condensed Consolidated Statements of Cash Flows (unaudited); (v) Consolidated Statement of Changes in Equity (unaudited); and (vi) Notes to Consolidated Financial Statements (unaudited).

† Filed herewith

‡ Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SAFEGUARD SCIENTIFICS, INC.

Date: October 25, 2018 /s/ Brian J. Sisko

Brian J. Sisko

President and Chief Executive Officer

Date: October 25, 2018 /s/ Mark A. Herndon

Mark A. Herndon

Senior Vice President and Chief Financial Officer