

SAFEGUARD SCIENTIFICS INC

Form 10-Q

August 03, 2007

Table of Contents

**SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

**FORM 10-Q
Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For Quarter Ended June 30, 2007**

**Commission File Number 1-5620
SAFEGUARD SCIENTIFICS, INC.
(Exact name of registrant as specified in its charter)**

Pennsylvania
*(State or other jurisdiction of
incorporation or organization)*

23-1609753
(I.R.S. Employer ID No.)

**435 Devon Park Drive
Building 800
Wayne, PA**
(Address of principal executive offices)

19087
(Zip Code)

(610) 293-0600

Registrant's telephone number, including area code

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

Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated
filer

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

Yes No

**Number of shares outstanding as of August 1, 2007
Common Stock 121,001,313**

**SAFEGUARD SCIENTIFICS, INC.
QUARTERLY REPORT ON FORM 10-Q
INDEX**

	Page
PART I - FINANCIAL INFORMATION	
Item 1 - Financial Statements:	
<u>Consolidated Balance Sheets June 30, 2007 (unaudited) and December 31, 2006</u>	3
<u>Consolidated Statements of Operations (unaudited) - Three and Six Months Ended June 30, 2007 and 2006</u>	4
<u>Consolidated Statements of Cash Flows (unaudited) - Six Months Ended June 30, 2007 and 2006</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
<u>Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 3 - Quantitative and Qualitative Disclosures About Market Risk</u>	47
<u>Item 4 - Controls and Procedures</u>	47
PART II - OTHER INFORMATION	
<u>Item 1A Risk Factors</u>	49
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	49
<u>Item 4 Submission of Matters to a Vote of Security Holders</u>	50
<u>Item 6 Exhibits</u>	51
<u>Signatures</u>	52
<u>Stock Option Grant Certificate Issued to Raymond J. Land</u>	
<u>Certification of Peter J. Boni pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934</u>	
<u>Certification of Raymond J. Land pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934</u>	
<u>Certification of Peter J. Boni pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>	
<u>Certification of Raymond J. Land pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>	

Table of Contents

**SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED BALANCE SHEETS**

	June 30, 2007	December 31, 2006
	(In thousands, except per share data)	
	(unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 76,816	\$ 67,012
Restricted cash - current	177	--
Marketable securities	53,807	94,155
Restricted marketable securities	3,869	3,869
Accounts receivable, less allowances (\$1,960 - 2007; \$1,713 - 2006)	36,427	33,167
Prepaid expenses and other current assets	5,870	5,080
Current assets of discontinued operations	--	11,703
Total current assets	176,966	214,986
Property and equipment, net	35,430	34,209
Ownership interests in and advances to companies	87,075	54,548
Long-term marketable securities	--	487
Long-term restricted marketable securities	3,874	5,737
Intangible assets, net	10,935	11,984
Goodwill	82,461	80,418
Cash held in escrow	22,180	19,398
Other	3,757	3,764
Non-current assets of discontinued operations	--	17,850
Total Assets	\$ 422,678	\$ 443,381
 LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Current portion of credit line borrowings	\$ 35,154	\$ 25,014
Current maturities of long-term debt	3,579	3,192
Accounts payable	6,220	10,581
Accrued compensation and benefits	10,747	13,432
Accrued expenses and other current liabilities	19,461	18,733
Deferred revenue	5,989	3,560
Current liabilities of discontinued operations	--	3,465
Total current liabilities	81,150	77,977
Long-term debt	4,873	4,010
Other long-term liabilities	10,235	10,319
Convertible senior debentures	129,000	129,000
Deferred taxes	1,026	1,026

Edgar Filing: SAFEGUARD SCIENTIFICS INC - Form 10-Q

Minority interest	5,135	5,491
Non-current liabilities of discontinued operations	--	1,656
Commitments and contingencies		
Redeemable subsidiary stock-based compensation	572	2,021
Shareholders' Equity:		
Preferred stock, \$0.10 par value; 1,000 shares authorized	--	--
Common stock, \$0.10 par value; 500,000 shares authorized; 120,976 and 120,419 shares issued and outstanding in 2007 and 2006, respectively	12,098	12,042
Additional paid-in capital	754,873	750,361
Accumulated deficit	(576,288)	(551,058)
Accumulated other comprehensive income	4	536
Total shareholders' equity	190,687	211,881
Total Liabilities and Shareholders' Equity	\$ 422,678	\$ 443,381

See Notes to Consolidated Financial Statements.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Six Months Ended June	
	June 30,		30,	
	2007	2006	2007	2006
	(in thousands, except per share data)			
	(unaudited)			
Revenue	\$ 43,732	\$ 39,286	\$ 83,241	\$ 76,592
Operating Expenses:				
Cost of sales	30,918	28,733	60,293	56,775
Selling, general and administrative	23,283	23,022	47,303	45,047
Research and development	509	441	1,381	1,081
Amortization of intangibles	525	627	1,049	1,247
Total operating expenses	55,235	52,823	110,026	104,150
Operating loss	(11,503)	(13,537)	(26,785)	(27,558)
Other income (loss), net	(747)	(1,228)	(646)	1,896
Interest income	2,169	1,576	4,328	3,115
Interest expense	(1,853)	(1,600)	(3,685)	(3,195)
Equity income (loss)	(3,450)	335	(5,179)	(270)
Minority interest	1,130	1,503	2,781	3,252
Net loss from continuing operations before income taxes	(14,254)	(12,951)	(29,186)	(22,760)
Income tax benefit	710	1,284	696	1,275
Net loss from continuing operations	(13,544)	(11,667)	(28,490)	(21,485)
Income (loss) from discontinued operations, net of tax	(21)	2,432	3,260	5,798
Net loss	\$ (13,565)	\$ (9,235)	\$ (25,230)	\$ (15,687)
Basic and Diluted Income (Loss) Per Share:				
Net loss from continuing operations	\$ (0.11)	\$ (0.10)	\$ (0.23)	\$ (0.18)
Net income (loss) from discontinued operations	--	0.02	0.02	0.05
Net loss per share	\$ (0.11)	\$ (0.08)	\$ (0.21)	\$ (0.13)
Shares used in computing basic and diluted income (loss) per share	122,338	121,499	122,227	121,390

See Notes to Consolidated Financial Statements.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2007 2006 (in thousands) (unaudited)	
Cash Flows from Operating Activities:		
Cash flows from operating activities of continuing operations	\$ (24,893)	\$ (15,169)
Cash flows from operating activities of discontinued operations	730	160
Net cash used in operating activities	(24,163)	(15,009)
Cash Flows from Investing Activities:		
Proceeds from sales of and distributions from companies and funds	2,304	1,712
Advances to companies	(191)	--
Acquisitions of ownership interests in companies and funds, net of cash acquired	(43,043)	(8,004)
(Recovery costs) repayments of note-receivable related party	--	(377)
Increase in marketable securities	(126,176)	(39,656)
Decrease in marketable securities	166,523	32,491
Proceeds from the sale of property and equipment	24	415
Capital expenditures	(5,467)	(7,771)
Capitalized software costs	(120)	(171)
Proceeds from sale of discontinued operations, net	29,967	6,154
Other, net	--	5
Cash flows from investing activities of discontinued operations	(362)	(3,065)
Net cash provided by (used in) investing activities	23,459	(18,267)
Cash Flows from Financing Activities:		
Repurchase of convertible senior debentures	--	(3,775)
Borrowings on revolving credit facilities	77,391	66,501
Repayments on revolving credit facilities	(67,251)	(61,731)
Borrowings on term debt	3,000	1,726
Repayments on term debt	(1,871)	(2,518)
Issuance of Company common stock, net	539	356
Issuance of subsidiary common stock, net	268	50
Offering costs on issuance of subsidiary common stock	--	(70)
Cash flows from financing activities of discontinued operations	(230)	(290)
Net cash provided by financing activities	11,846	249
Net Increase (Decrease) in Cash and Cash Equivalents	11,142	(33,027)
	(1,338)	348

Edgar Filing: SAFEGUARD SCIENTIFICS INC - Form 10-Q

Changes in cash and cash equivalents from Pacific Title and Art Studio and Mantas included in assets of discontinued operations

Cash and Cash Equivalents at beginning of period	67,012	122,069
Cash and Cash Equivalents at end of period	\$ 76,816	\$ 89,390

See Notes to Consolidated Financial Statements.

5

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2007

1. GENERAL

The accompanying unaudited interim Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States of America and the interim financial statements rules and regulations of the SEC. In the opinion of management, these statements include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Consolidated Financial Statements. The interim operating results are not necessarily indicative of the results for a full year or for any interim period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations relating to interim financial statements. The Consolidated Financial Statements included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-Q and included together with the Company's Consolidated Financial Statements and Notes thereto included in the Company's 2006 Annual Report on Form 10-K.

2. BASIS OF PRESENTATION

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

The Company's Consolidated Statements of Operations and Consolidated Statements of Cash Flows for the three and six months ended June 30, 2007 and 2006 and Consolidated Balance Sheets at June 30, 2007 and December 31, 2006 include the following subsidiaries in continuing operations:

Acsis, Inc. (Acsis)

Alliance Consulting Group Associates, Inc. (Alliance Consulting)

Clariant, Inc. (Clariant)

Laureate Pharma, Inc. (Laureate Pharma)

Alliance Consulting operates on a 52 or 53-week fiscal year, ending on the Saturday closest to the end of the fiscal period. The Company and all other subsidiaries operate on a calendar year. Alliance Consulting's second quarter ended on June 30, 2007 and July 1, 2006, each a period of 13 weeks and year-to-date a period of 26 weeks.

During 2007 and 2006, certain consolidated companies, or components thereof, were sold. See Note 3 for discontinued operations treatment of Pacific Title and Art Studio, Clariant's technology group business, Mantas and Alliance Consulting's Southwest region.

3. DISCONTINUED OPERATIONS

Pacific Title and Art Studio

In March 2007, the Company sold Pacific Title and Art Studio for net cash proceeds of approximately \$21.9 million including \$2.3 million cash held in escrow. As a result of the sale, the Company recorded a pre-tax gain of \$2.7 million in the first quarter of 2007. Pacific Title and Art Studio is reported in discontinued operations for all periods presented.

Clariant Technology Group

In March 2007, Clariant sold its technology group business (which developed, manufactured and marketed the ACIS Automated Image Analysis System) and related intellectual property to Carl Zeiss MicroImaging, Inc. (the ACIS Sale) for net cash proceeds of \$10.3 million (excluding \$1.5 million in contingent purchase price). As a result of the sale, Clariant recorded a pre-tax gain of \$3.6 million in the first quarter of 2007. The technology group business is reported in discontinued operations for all periods presented. Goodwill of \$2.1 million related to the technology group business was included in discontinued operations.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

Mantas

In October 2006, the Company sold its interest in Mantas for net cash proceeds of approximately \$112.8 million, including \$19.3 million held in escrow. The Company recorded a pre-tax gain of \$83.9 million in the fourth quarter of 2006. Mantas is reported in discontinued operations for the three and six months ended June 30, 2006. Mantas sold its telecommunications business and certain related assets and liabilities in the first quarter of 2006 for \$2.1 million in cash. As a result of the sale, Mantas recorded a gain of \$1.9 million in the first quarter of 2006, which is also reported in discontinued operations.

Alliance Consulting Southwest Region

Alliance Consulting sold its Southwest region in May 2006 for proceeds of \$4.5 million, including cash of \$3.0 million and stock of the acquiror of \$1.5 million which was subsequently sold. As a result of the sale, Alliance Consulting recorded a gain of \$1.6 million in the second quarter of 2006. Alliance Consulting's Southwest region is reported in discontinued operations for the three and six months ended June 30, 2006.

Results of all discontinued operations were as follows:

	Three Months Ended		Six Months Ended June	
	June 30,		30,	
	2007	2006	2007	2006
	(in thousands)			
	(unaudited)			
Revenue	\$ --	\$ 18,120	\$ 7,326	\$ 39,210
Operating expenses	--	(17,119)	(8,098)	(36,741)
Other	--	(361)	(103)	(546)
Net income (loss) before income taxes and minority interest	--	640	(875)	1,923
Income tax (expense) benefit	--	(101)	8	(174)
Income (loss) from operations	--	539	(867)	1,749
Gain (loss) on disposal, net of tax	(36)	1,501	6,292	3,409
Minority interest	15	392	(2,165)	640
Income (loss) from discontinued operations, net of tax	\$ (21)	\$ 2,432	\$ 3,260	\$ 5,798

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

The assets and liabilities of the discontinued operations were as follows:

	December 31, 2006 (in thousands)
Cash	\$ 4,239
Accounts receivable, less allowances	5,393
Inventory	1,525
Other current assets	546
Total current assets	11,703
Property and equipment, net	10,680
Intangibles	4,442
Goodwill	2,080
Other assets	648
Total Assets	\$ 29,553
Current debt	\$ 746
Accounts payable	530
Accrued expenses	1,499
Deferred revenue	690
Total current liabilities	3,465
Long-term debt	1,057
Other long-term liabilities	599
Total Liabilities	\$ 5,121
Carrying value	\$ 24,432

4. MARKETABLE SECURITIES

Marketable securities included the following:

	Current		Non-Current	
	June 30, 2007	December 31, 2006	June 30, 2007	December 31, 2006
	(in thousands)			
	(unaudited)		(unaudited)	
Held-to-maturity:				
Commercial paper	\$ 53,807	\$ 94,155	\$ --	\$ --
Restricted U.S. Treasury securities	3,869	3,869	3,874	5,737

	57,676	98,024	3,874	5,737
Available-for-sale: Equity securities	--	--	--	487
	\$ 57,676	\$ 98,024	\$ 3,874	\$ 6,224

As of June 30, 2007, the contractual maturities of securities were as follows:

	Years to Maturity (in thousands) (unaudited)				
	Less Than One Year	One to Five Years	No Single Maturity Date		Total
Held-to-maturity	\$ 57,676	\$ 3,874	\$ --	--	\$ 61,550

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

During the three months ended June 30, 2007, the Company's investment in available-for-sale securities was written-off due to the cancellation of the underlying securities in bankruptcy liquidation. The change is reflected in Accumulated Other Comprehensive Income on the Consolidated Balance Sheets.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

The following is a summary of changes in the carrying amount of goodwill by segment:

	Alliance Consulting	Clariant	Acsis	Total
		(in thousands)		
		(unaudited)		
Balance at December 31, 2006	\$ 56,155	\$ 12,729	\$ 11,534	\$ 80,418
Purchase price adjustments	2,043	--	--	2,043
Balance at June 30, 2007	\$ 58,198	\$ 12,729	\$ 11,534	\$ 82,461

In July 2006, Alliance Consulting acquired Fusion Technologies for \$5.4 million in cash. Based on achievement of earnings targets by the Fusion business in the post-acquisition period, additional purchase price consideration of \$2.0 million was recorded by Alliance in the three months ended June 30, 2007, comprising \$1.7 million in cash and \$0.3 million in Alliance Consulting common stock. Certain purchase price adjustments related to this acquisition are not final.

Intangible assets with definite useful lives are amortized over their respective estimated useful lives to their estimated residual values. The following table provides a summary of the Company's intangible assets with definite and indefinite useful lives:

	June 30, 2007			
	Amortization Period	Gross Carrying Value	Accumulated Amortization	Net
		(In thousands)		
		(unaudited)		
Customer-related	7 - 10 years	\$ 9,721	\$ 3,280	\$ 6,441
Technology-related	3 years	1,376	726	650
Process-related	3 years	1,363	1,212	151
Tradenames	20 years	1,222	96	1,126
		13,682	5,314	8,368
Tradenames	Indefinite	2,567	--	2,567
Total		\$ 16,249	\$ 5,314	\$ 10,935

		December 31, 2006		
	Amortization	Gross	Accumulated	Net
	Period	Carrying	Amortization	
		Value	(In thousands)	
	7 - 10			
Customer-related	years	\$ 9,721	\$ 2,719	\$ 7,002
Technology-related	3 years	1,376	496	880
Process-related	3 years	1,363	984	379
	20			
Tradenames	years	1,222	66	1,156
		13,682	4,265	9,417
Tradenames	Indefinite	2,567	--	2,567
Total		\$ 16,249	\$ 4,265	\$ 11,984

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

Amortization expense related to intangible assets was \$0.5 million and \$1.0 million for the three and six months ended June 30, 2007, and \$0.6 million and \$1.2 million for the three and six months ended June 30, 2006, respectively. The following table provides estimated future amortization expense related to intangible assets:

	Total (In thousands) (unaudited)
Remainder of 2007	\$ 978
2008	1,610
2009	1,164
2010	670
2011 and thereafter	3,946
	\$ 8,368

6. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2007, the AICPA issued Statement of Position 07-1, Clarification of the Scope of the Audit and Accounting Guide: Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies (SOP 07-1). SOP 07-1 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide: Investment Companies (the Guide). SOP 07-1 amends the Guide to include criteria for determining whether an entity is an investment company for accounting purposes and is therefore within the Guide s scope. Those criteria include a definition of an investment company and factors to consider in determining whether an entity meets that definition. Entities meeting the definition of an investment company, as well as entities regulated by the Investment Company Act of 1940 or similar requirements, are required to follow the Guide s specialized accounting guidance. SOP 07-01 is effective for fiscal years beginning on or after December 15, 2007. The Company is currently evaluating the applicability of SOP 07-01.

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

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect the adoption of SFAS No. 157 to have a material impact on its financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained upon examination by the applicable taxing authority. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 effective January 1, 2007. See Note

11.

10

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

7. COMPREHENSIVE LOSS

Comprehensive loss is the change in equity of a business enterprise from transactions and other events and circumstances from non-owner sources. Excluding net loss, the Company's sources of comprehensive loss are from net unrealized appreciation (depreciation) on its holdings classified as available-for-sale and foreign currency translation adjustments.

The following summarizes the components of comprehensive loss:

	Three Months Ended June 30, 2007		Six Months Ended June 30, 2006	
	2006		2007	
	(in thousands) (unaudited)			
Net loss from continuing operations	\$ (13,544)	\$ (11,667)	\$ (28,490)	\$ (21,485)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(45)	118	(45)	87
Unrealized holding losses on available-for-sale securities	(65)	(1,956)	(487)	(2,182)
Other comprehensive loss from continuing operations	(110)	(1,838)	(532)	(2,095)
Comprehensive loss from continuing operations	(13,654)	(13,505)	(29,022)	(23,580)
Net income (loss) from discontinued operations	(21)	2,432	3,260	5,798
Comprehensive loss	\$ (13,675)	\$ (11,073)	\$ (25,762)	\$ (17,782)

8. LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Consolidated long-term debt consisted of the following:

	June 30, 2007	December 31, 2006
	(in thousands) (unaudited)	
Subsidiary credit line borrowings (guaranteed by the Company)	\$ 25,000	\$ 22,000
Subsidiary credit line borrowings (not guaranteed by the Company)	10,154	3,014
Subsidiary term loans and other borrowings (guaranteed by the Company)	5,250	3,000
	40,404	28,014
Capital lease obligations and other borrowings	3,202	4,202
	43,606	32,216

Less current maturities	(38,733)	(28,206)
Total long-term debt, less current portion	\$ 4,873	\$ 4,010

The Company maintains a revolving credit facility that provides for borrowings and issuances of letters of credit and guarantees. On May 2, 2007, the revolving credit facility was amended to extend the expiration date to June 30, 2008. In addition, the credit facility was increased from \$55 million to \$75 million and the Company's guarantee on a partner company facility was increased from \$5 million to \$7.5 million. Borrowing availability under the facility is reduced by the amounts outstanding for the Company's borrowings and letters of credit and amounts guaranteed under partner company facilities maintained with that same lender. This credit facility bears interest at the prime rate (8.25% at June 30, 2007) for outstanding borrowings. The credit facility is subject to an unused commitment fee of 0.125%, which is subject to reduction based on deposits maintained at the bank. The facility requires cash collateral equal to one times the Company's borrowings and letters of credit and amounts borrowed by partner companies under facilities maintained with that same bank.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

In November 2006, the Company entered into an additional revolving credit facility with a separate bank that provides for borrowings and issuances of letters of credit and guarantees of up to \$20 million. Borrowing availability under the facility is reduced by the amounts outstanding for the Company's borrowings and letters of credit and amounts guaranteed under partner company facilities maintained with that same lender. This credit facility bears interest at the prime rate for outstanding borrowings. The credit facility is subject to an unused commitment fee of 0.125%, which is subject to reduction based on deposits maintained at the bank. The facility requires cash collateral equal to one times the Company's borrowings and letters of credit and amounts borrowed by partner companies under the guaranteed portion of the partner company facilities maintained at the same bank. The credit facility matures in November 2007.

Availability under the Company's revolving credit facilities at June 30, 2007 was as follows (in thousands):

	Total
Size of facilities	\$ 95,000
Subsidiary facilities at same banks (a)	(40,800)
Outstanding letter of credit (b)	(6,336)
Amount available	\$ 47,864

- (a) The Company's availability under its credit facilities is reduced by the amounts borrowed by the Company and letters of credit and amounts guaranteed under partner company facilities maintained at the same respective banks. Of the total facilities, \$30.3 million was outstanding under these facilities at June 30, 2007 and was included as debt on the Consolidated Balance Sheet.
- (b) In connection with the sale of CompuCom, the Company provided to the landlord of CompuCom's Dallas headquarters lease, a letter of credit, which will expire on March 19, 2019, in an amount equal to \$6.3 million.

Alliance Consulting, Clariant and Laureate Pharma maintain credit facilities with the same lender as the Company. Borrowings are secured by substantially all of the assets of the respective subsidiaries. These obligations bear interest at variable rates ranging between the prime rate minus 0.5% and the prime rate plus 0.5%. These facilities contain financial and non-financial covenants. During the three months ended June 30, 2007, Alliance Consulting and Clariant each did not comply with certain of their financial covenants under their respective facilities and subsequently received waivers from the lender.

In July 2007, Acsis amended and restated its credit facility with its bank, providing up to \$4.5 million of availability, subject to a borrowing base calculation. The facility expires in July 2008 and bears interest at rates ranging from the prime rate plus 1.5% to the prime rate plus 2.25% depending on Acsis' liquidity. In addition, in July 2007, Acsis entered into a \$1.5 million loan facility with the same bank which expires on September 15, 2007 and bears interest at the prime rate. The \$1.5 million facility is guaranteed by the Company.

In September 2006, Clariant entered into a \$5 million senior secured revolving credit agreement. Borrowing availability under the agreement is based on the level of Clariant's qualified accounts receivable, less certain reserves. The agreement has a two-year term and bears interest at variable rates based on the lower of LIBOR plus 3.25% or the prime rate plus 0.5%. As of June 30, 2007, Clariant had \$1.3 million outstanding borrowings under this facility and had \$2.2 million availability based on the level of qualified accounts receivable. During the three months ended June 30, 2007 Clariant did not comply with certain of its financial covenants under this facility and subsequently

received a waiver from the lender.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

Debt as of June 30, 2007 and December 31, 2006 bore interest at fixed rates between 4.62% and 20.33% and variable rates indexed to the prime rate plus 0.5%.

The Company's debt matures as follows:

	Total (in thousands)
Remainder of 2007	\$ 2,007
2008	38,228
2009	2,484
2010	762
2011 and thereafter	125
Total debt	\$ 43,606

9. CONVERTIBLE SENIOR DEBENTURES

In February 2004, the Company completed the sale of \$150 million of 2.625% convertible senior debentures with a stated maturity of March 15, 2024. Interest on the 2024 Debentures is payable semi-annually. At the debenture holders' option, the 2024 Debentures are convertible into Company common stock through March 14, 2024, subject to certain conditions. The conversion rate of the debentures at June 30, 2007 was \$7.2174 of principal amount per share. The closing price of the Company's common stock at June 30, 2007 was \$2.81. The 2024 Debenture holders may require repurchase of the debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount plus accrued and unpaid interest. The 2024 Debenture holders may also require repurchase of the debentures upon certain events, including sale of all or substantially all of the Company's common stock or assets, liquidation, dissolution or a change in control. Subject to certain conditions, the Company may redeem all or some of the 2024 Debentures commencing March 20, 2009. During the first quarter of 2006, the Company repurchased \$5 million of the face value of the 2024 Debentures for \$3.8 million in cash. In connection with the repurchase, the Company recorded \$0.1 million of expense related to the acceleration of deferred debt issuance costs associated with the 2024 Debentures, resulting in a net gain of \$1.1 million, which is included in Other Income (Loss), Net in the Consolidated Statements of Operations. At June 30, 2007, the outstanding 2024 Debentures had a face value of \$129 million and a market value of approximately \$111 million, based on quoted market prices.

As required by the terms of the 2024 Debentures, after completing the sale of CompuCom in October 2004, the Company escrowed \$16.7 million for interest payments through March 15, 2009 on the 2024 Debentures. A total of \$7.7 million is included in Restricted Marketable Securities on the Consolidated Balance Sheet at June 30, 2007, of which \$3.9 million is classified as a current asset.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

10. STOCK-BASED COMPENSATION

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

Classification of Stock-Based Compensation Expense

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands) (unaudited)			
Cost of sales	\$ 48	\$ 16	\$ 110	\$ 36
Selling, general and administrative	1,559	1,653	3,358	3,492
Research and development	8	14	49	18
	\$ 1,615	\$ 1,683	\$ 3,517	\$ 3,546

The Company

The fair value of the Company's stock-based awards to employees are estimated at the date of grant using the Black-Scholes option-pricing model. The risk-free rate is based on the U.S. Treasury yield curve in effect at the end of the quarter. The expected life of stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility for a period equal to the stock option's expected life.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(unaudited)			
Service-Based Awards				
Dividend yield	0%	0%	0%	0%
Expected volatility	62%	73%	62%	73%
	5	5	5 years	5 years
Average expected option life	years	years		
Risk-free interest rate	4.6%	5.2%	4.6%	5.1%
Market-Based Awards				
Dividend yield	0%	0%	0%	0%
Expected volatility	55%	67%	56%	67%
	6	6	6 years	6 years
Average expected option life	years	years		
Risk-free interest rate	4.9%	5.2%	4.9%	5.0%

Market-based awards entitle participants to vest in a number of options determined by achievement of certain target market capitalization increases (measured by reference to stock price increases on a specified number of outstanding shares) over an eight-year period. The requisite service periods for the market-based awards are based on the Company's estimate of the dates on which the market conditions will be met. Compensation expense is recognized over the requisite service periods using the straight-line method, but is accelerated if market capitalization targets are achieved earlier than estimated. Based on the achievement of market capitalization targets, 0.3 million and 0.5 million shares vested during the three and six months ended June 30, 2007. The Company recorded \$0.5 million and \$1.1 million of compensation expense related to these awards during the three and six months ended June 30, 2007 and \$0.7 million and \$1.4 million during the three and six months ended June 30, 2006, respectively. Depending on the Company's stock performance, the maximum number of unvested shares at June 30, 2007 attainable under these grants is 8.6 million shares.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

All other outstanding options are service-based awards that generally vest over four years after the date of grant and expire eight years after the date of grant. Compensation expense is recognized over the requisite service period using the straight-line method. The requisite service period for service-based awards is the period over which the award vests. The Company recorded \$0.6 million and \$1.0 million of compensation expense related to these awards during the three and six months ended June 30, 2007 and \$0.4 million and \$0.8 million during the three and six months ended June 30, 2006, respectively.

Consolidated Subsidiaries

The fair value of the Company's subsidiaries' stock-based awards to employees are estimated at the date of grant using the Black-Scholes option-pricing model. The risk-free rate is based on the U.S. Treasury yield curve in effect at the end of the quarter in which the grant occurred. The expected life of stock options granted was estimated using the historical exercise behavior of employees. The expected life of stock options granted for subsidiaries that do not have sufficient historical exercise behavior of employees was calculated using the simplified method of determining expected term as provided in Staff Accounting Bulletin No. 107, Share-Based Payment (SAB 107). Expected volatility for publicly-held subsidiaries was based on historical volatility for a period equal to the stock option's expected life. Expected volatility for privately-held subsidiaries is based on the average historical volatility of comparable companies for a period equal to the stock option's expected life. The fair value of the underlying stock of privately-held subsidiaries on the date of grant was determined based on a number of valuation methods, including discounted cash flows and revenue and acquisition multiples.

Stock options granted by subsidiaries generally are service-based awards that vest four years after the date of grant and expire 7 to 10 years after the date of grant. Compensation expense is recognized over the requisite service period using the straight-line method. The requisite service period is the period over which the award vests. The Company's consolidated subsidiaries recorded compensation expense related to these awards of \$0.5 million and \$1.4 million during the three and six months ended June 30, 2007 and \$0.6 million and \$1.3 million during the three and six months ended June 30, 2006.

Certain employees of the Company's subsidiaries have the right to require the respective subsidiary to purchase shares of common stock of the subsidiary received by the employee pursuant to the exercise of options. The employee must hold the shares for at least six months prior to exercising this right. The required purchase price is 75% to 100% of the fair market value at the time the right is exercised. These options qualify for equity-classification under SFAS No. 123(R). In accordance with EITF Issue No. D-98, however, these instruments are classified outside of permanent equity as redeemable subsidiary stock-based compensation on the Consolidated Balance Sheets at their redemption amount based on the number of options vested as of June 30, 2007 and December 31, 2006. Following the sale of Pacific Title and Art Studio, amounts payable related to deferred stock units issued to a former employee of Pacific Title and Art Studio were classified in accrued expenses and other current liabilities on the Consolidated Balance Sheet at June 30, 2007 at the expected redemption amount. At December 31, 2006, these instruments were classified outside of permanent equity as redeemable subsidiary stock-based compensation.

11. INCOME TAXES

The Company's consolidated income tax benefit for the six months ended June 30, 2007 was \$0.7 million. The net tax benefit relates to the reversal of reserves that relate to uncertain tax positions for which the statute of limitations expired during the period in the applicable tax jurisdictions and the Company's share of net state tax expense recorded by subsidiaries. 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 net operating loss benefit that would have been recognized in 2007 was offset by a valuation allowance.

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Adoption of FIN 48 had no impact on the Company's consolidated results of operations and

financial position.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

Upon adoption of FIN 48, the Company identified uncertain tax positions that the Company currently does not believe meet the more likely than not recognition threshold under FIN 48 to be sustained upon examination. Because these uncertain tax positions have not been utilized and had a full valuation allowance established, the Company reduced the gross deferred tax asset and valuation allowance by \$3.2 million. This amount relates to unrecognized tax benefits that would impact the effective tax rate if recognized absent the valuation allowance.

The Company and its consolidated partner companies file income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Tax years 2003 and forward remain open for examination for federal tax purposes and tax years 2002 and forward remain open for examination for the Company's more significant state tax jurisdictions. To the extent utilized in future years' tax returns, net operating loss and capital loss carryforwards at June 30, 2007 will remain subject to examination until the respective tax year is closed.

At December 31, 2006, the Company had accrued \$0.8 million for unrecognized tax benefits, including \$0.2 million for the payment of penalties and interest. The Company recognizes penalties and interest accrued related to income tax liabilities in the provision (benefit) for income taxes in its consolidated statements of operations. Substantially all of the unrecognized tax benefits at December 31, 2006 were recognized in the three months ended June 30, 2007 as the applicable statutes of limitations expired.

12. NET LOSS PER SHARE

The calculations of net loss per share were:

	Three Months Ended		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands except per share data)			
	(unaudited)			
Basic:				
Net loss from continuing operations	\$ (13,544)	\$ (11,667)	\$ (28,490)	\$ (21,485)
Net income (loss) from discontinued operations	(21)	2,432	3,260	5,798
Net loss	\$ (13,565)	\$ (9,235)	\$ (25,230)	\$ (15,687)
Average common shares outstanding	122,338	121,499	122,227	121,390
Net loss from continuing operations	\$ (0.11)	\$ (0.10)	\$ (0.23)	\$ (0.18)
Net income (loss) from discontinued operations	--	0.02	0.02	0.05
Net loss per share	\$ (0.11)	\$ (0.08)	\$ (0.21)	\$ (0.13)
Diluted:				
Net loss from continuing operations principle	\$ (13,544)	\$ (11,667)	\$ (28,490)	\$ (21,485)
Net income (loss) from discontinued operations	(21)	2,432	3,260	5,798
Effect of holdings	--	(34)	--	(49)
Adjusted net loss	\$ (13,565)	\$ (9,269)	\$ (25,230)	\$ (15,736)

Edgar Filing: SAFEGUARD SCIENTIFICS INC - Form 10-Q

Average common shares outstanding	122,338	121,499	122,227	121,390
Net loss per share from continuing operations	\$ (0.11)	\$ (0.10)	\$ (0.23)	\$ (0.18)
Net income (loss) per share from discontinued operations	--	0.02	0.02	0.05
Diluted loss per share	\$ (0.11)	\$ (0.08)	\$ (0.21)	\$ (0.13)

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).

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

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

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

At June 30, 2007 and 2006, options to purchase 20.6 million and 19.1 million shares of common stock at prices ranging from \$1.03 to \$45.47 per share, were excluded from the calculations;

At June 30, 2007 and 2006, unvested shares of restricted stock and unvested deferred stock units totaling 0.1 million shares were excluded from the calculations; and

At June 30, 2007 and 2006 a total, of 17.9 million and 20.1 million shares, respectively, related to the Company's 2024 Debentures (See Note 9) representing the weighted average effect of assumed conversion of the 2024 Debentures were excluded from the calculations.

13. PARENT COMPANY FINANCIAL INFORMATION

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

Parent Company Balance Sheets

	June 30, 2007	December 31, 2006
	(In thousands)	
	(unaudited)	
Assets:		
Cash and cash equivalents	\$ 71,928	\$ 59,933
Restricted cash	177	--
Marketable securities	53,807	94,155
Restricted marketable securities	3,869	3,869
Other current assets	1,804	1,978
Asset held for sale	--	17,852
Total current assets	131,585	177,787
Ownership interests in and advances to companies	182,744	160,557
Long-term marketable securities	--	487
Long-term restricted marketable securities	3,874	5,737
Cash held in escrow	22,180	19,398
Other	2,966	3,377
Total Assets	\$ 343,349	\$ 367,343
Liabilities and Shareholders' Equity:		
Current liabilities	\$ 17,672	\$ 18,816
Long-term liabilities	5,418	5,625
Convertible senior debentures	129,000	129,000

Edgar Filing: SAFEGUARD SCIENTIFICS INC - Form 10-Q

Shareholders' equity	191,259	213,902
Total Liabilities and Shareholders' Equity	\$ 343,349	\$ 367,343

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

Parent Company Statements of Operations	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
	(unaudited)			
Operating expenses	\$ (5,465)	\$ (5,342)	\$ (11,739)	\$ (10,944)
Other income (loss), net	(744)	(1,237)	(689)	1,877
Interest income	2,142	1,555	4,260	3,037
Interest expense	(1,053)	(1,190)	(2,110)	(2,404)
Equity loss	(9,134)	(6,737)	(18,922)	(14,335)
Net loss from continuing operations before income taxes	(14,254)	(12,951)	(29,200)	(22,769)
Income tax benefit	710	1,284	710	1,284
Equity income (loss) attributable to discontinued operations	(21)	2,432	3,260	5,798
Net loss	\$ (13,565)	\$ (9,235)	\$ (25,230)	\$ (15,687)

Parent Company Statements of Cash Flows	Six Months Ended June 30,	
	2007	2006
	(in thousands)	
	(unaudited)	
Net cash used in operating activities	\$ (9,350)	\$ (5,710)

Cash Flows from Investing Activities:

Proceeds from sales of and distributions from companies and funds	2,304	517
Advances to companies	(191)	--
Acquisitions of ownership interests in companies and funds, net of cash acquired	(41,309)	(14,004)
Recovery costs of note receivable related party	--	(377)
Increase in marketable securities	(126,176)	(39,656)
Decrease in marketable securities	166,523	32,491
Capital expenditures	--	(76)
Proceeds from sale of discontinued operations	19,655	--
Other, net	--	1,200
Net cash provided by (used in) investing activities	20,806	(19,905)

Cash Flows from Financing Activities:

Repurchase of convertible senior debentures	--	(3,775)
---	----	---------

Edgar Filing: SAFEGUARD SCIENTIFICS INC - Form 10-Q

Advanced to subsidiary	--	(500)
Issuance of company common stock, net	539	356
Net cash provided by (used) in financing activities	539	(3,919)
Net Increase (Decrease) in Cash and Cash Equivalents	11,995	(29,534)
Cash and Cash Equivalents at beginning of period	59,933	108,300
Cash and Cash Equivalents at end of period	\$ 71,928	\$ 78,766

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

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

14. OPERATING SEGMENTS

The Company presents its consolidated partner companies as separate segments Acsis, Alliance Consulting, Clariant and Laureate Pharma. The results of operations of the Company's non-consolidated partner companies and the Company's ownership in private equity funds are reported in the Other Companies segment. The Other Companies segment also includes the gain or loss on the sale of companies and funds, except for gains and losses included in discontinued operations.

Management evaluates segment performance based on segment revenue, operating income (loss) and income (loss) before income taxes, which reflects the portion of income (loss) allocated to minority shareholders.

Other Items includes certain expenses, which are not identifiable to the operations of the Company's operating business segments. Other Items primarily consists of general and administrative expenses related to corporate operations, including employee compensation, insurance and professional fees including legal, finance and consulting, interest income and interest expense. Other Items also includes income taxes, which are reviewed by management independent of segment results.

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

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

As of June 30, 2007 and December 31, 2006, the Company's assets were primarily located in the United States.

The following represents the segment data from continuing operations:

Three Months Ended June 30, 2007
(in thousands)
(unaudited)

	Acsis	Alliance Consulting	Clariant	Laureate Pharma	Other Companies	Total Segments	Other Items	Total Continuing Operations
Revenue	\$ 5,140	\$ 21,393	\$ 10,336	\$ 6,863	\$ --	\$ 43,732	\$ --	\$ 43,732
Operating loss	(2,211)	(1,232)	(2,309)	(286)	--	(6,038)	(5,465)	(11,503)
Net loss	(2,227)	(1,437)	(1,473)	(547)	(4,250)	(9,934)	(3,610)	(13,544)
Segment Assets								
June 30, 2007	\$ 23,285	\$ 84,983	\$ 37,165	\$ 29,565	\$ 87,075	\$ 262,073	\$ 160,605	\$ 422,678
December 31, 2006	27,266	83,766	33,688	25,626	55,035	225,381	188,447	413,828

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

Three Months Ended June 30, 2006
(in thousands)
(unaudited)

	Acsis	Alliance Consulting	Clariant	Laureate Pharma	Other Companies	Total Segments	Other Items	Total Continuing Operations
Revenue	\$ 4,584	\$ 25,868	\$ 6,366	\$ 2,468	\$ --	\$ 39,286	\$ --	\$ 39,286
Operating loss	(1,884)	(678)	(3,155)	(2,478)	--	(8,195)	(5,342)	(13,537)
Net loss	(1,776)	(828)	(1,834)	(2,634)	(958)	(8,030)	(3,637)	(11,667)

Six Months Ended June 30, 2007
(in thousands)
(unaudited)

	Acsis	Alliance Consulting	Clariant	Laureate Pharma	Other Companies	Total Segments	Other Items	Total Continuing Operations
Revenue	\$ 9,355	\$ 42,850	\$ 19,193	\$ 11,843	\$ --	\$ 83,241	\$ --	\$ 83,241
Operating loss	(4,850)	(2,745)	(5,575)	(1,876)	--	(15,046)	(11,739)	(26,785)
Net loss	(4,867)	(3,096)	(3,430)	(2,336)	(5,979)	(19,708)	(8,782)	(28,490)

Six Months Ended June 30, 2006
(in thousands)
(unaudited)

	Acsis	Alliance Consulting	Clariant	Laureate Pharma	Other Companies	Total Segments	Other Items	Total Continuing Operations
Revenue	\$ 8,985	\$ 51,080	\$ 11,881	\$ 4,646	\$ --	\$ 76,592	\$ --	\$ 76,592
Operating loss	(4,128)	(950)	(6,814)	(4,722)	--	(16,614)	(10,944)	(27,558)
Net income (loss)	(3,905)	(1,314)	(3,873)	(4,964)	350	(13,706)	(7,779)	(21,485)

Other Items

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006

(in thousands)
(unaudited)

Corporate operations	\$ (4,320)	\$ (4,921)	\$ (9,478)	\$ (9,054)
Income tax benefit (expense)	710	1,284	696	1,275
	\$ (3,610)	\$ (3,637)	\$ (8,782)	\$ (7,779)

15. BUSINESS COMBINATIONS*Acquisitions by the Company*

In June 2007, the Company acquired 40% of Cellumen, Inc. for \$6.0 million in cash. Cellumen is a cellular systems biology company whose technology optimizes the drug discovery process. The Company accounts for its holdings in Cellumen under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Cellumen was allocated to in-process research and development, resulting in a \$0.2 million charge in the second quarter of 2007, and to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheet.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

In June 2007, the Company increased its ownership interest in Authentium, Inc. to 20%, for \$3.0 million in cash. The Company had previously acquired a 12% interest in Authentium in April 2006 for \$5.5 million in cash. Authentium is a provider of security software to internet service providers. The Company accounts for its holdings in Authentium under the cost method.

In May 2007, the Company acquired 14% of Avid Radiopharmaceuticals (Avid) for \$7.3 million in cash. Avid develops molecular imaging products for neurodegenerative diseases. The Company accounts for its holdings in Avid under the cost method.

In May 2007, the Company increased its ownership interest in Advanced BioHealing, Inc. (ABH) to 28% for \$2.7 million in cash. The Company had previously acquired a 24% interest in ABH in February 2007 for \$8.0 million in cash. ABH is a specialty biotechnology company focused on the development and marketing of cell-based and tissue engineered products. The Company accounts for its holdings in ABH under the equity method. The difference between the Company's cost and its interest in the underlying net assets of ABH was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheet.

In March 2007, the Company acquired 37% of Beyond.com for \$13.5 million in cash. Beyond.com is a provider of online technology and career services to job seekers and corporations. The Company accounts for its holdings in Beyond.com under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Beyond.com was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheet.

In November 2006, the Company acquired 32% of Advantedge Healthcare Solutions (AHS) for \$5.8 million in cash. AHS is a New York based technology-enabled service provider that delivers medical billing services to physician groups. The Company accounts for its holdings in AHS under the equity method. The difference between the Company's cost and its interest in underlying net assets of AHS was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheet.

In September 2006, the Company acquired additional common shares of Clariant for \$3 million in cash to fund Clariant's acquisition of Trestle Holdings, Inc. (Trestle). As a result of the funding, the Company's ownership in Clariant increased to 60%. The difference between the Company's cost and its interest in the underlying net assets of Clariant was allocated to intangible assets of \$0.8 million with estimated useful lives of 5 years and to fixed assets of \$0.2 million with estimated depreciable lives of 3 years.

In September 2006, the Company acquired 24% of NuPathe, Inc. for \$3 million in cash. NuPathe develops therapeutics in conjunction with novel transdermal delivery technologies. The Company accounts for its holdings in NuPathe under the equity method. The difference between the Company's cost and its interest in the underlying net assets of NuPathe was allocated to in-process-research and development, resulting in a \$1.0 million charge in 2006, and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheet.

In August 2006, the Company acquired 47% of Portico Systems (Portico) for \$6 million in cash. Portico is a software solutions provider for regional and national health plans looking to optimize provider network operations and streamline business processes. The Company accounts for its holdings in Portico under the equity method. The difference between the Company's cost and its interest in the underlying net assets of Portico was allocated to intangible assets and goodwill, as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheet.

In August 2006, the Company acquired 36% of Rubicor Medical, Inc. (Rubicor) for \$20 million in cash. Rubicor develops and distributes technologically advanced, disposable, minimally-invasive breast biopsy devices. The Company accounts for its holdings in Rubicor under the equity method. The difference between the Company's cost and its interest in

Table of Contents

SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)
JUNE 30, 2007

the underlying net assets of Rubicor was allocated to in-process-research and development, resulting in a \$0.6 million charge in 2006, and intangible assets as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheet.

In June 2006, the Company acquired additional common shares of Acsis for an aggregate purchase price of \$6 million in cash at the same per-share value as the December 2005 acquisition. The result of the June 2006 incremental equity purchase was an increase in ownership in Acsis to 96%. The capital provided is being used by Acsis to support its long-term growth strategy.

16. COMMITMENTS AND CONTINGENCIES

The Company, and its partner companies, are involved in various claims and legal actions arising in the ordinary course of business, and which may from time to time arise from facility lease terminations. While in the current opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position or results of operations, no assurance can be given as to the outcome of these lawsuits, 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 our companies.

In connection with its ownership interests in certain affiliates, the Company had the following outstanding guarantees at June 30, 2007:

	Amount	Debt Included on Consolidated Balance Sheet
	(in thousands)	
Consolidated company guarantees - credit facilities	\$ 40,800	\$ 30,250
Consolidated company guarantees - other	4,748	--
Non-consolidated company guarantees	3,750	--
Total	\$ 49,298	\$ 30,250

The Company has committed capital of approximately \$5.7 million, including a conditional commitment to provide a partner company with additional funding and commitments made to various private equity funds in prior years. These commitments will be funded over the next several years, including approximately \$4.8 million which is expected to be funded during the next twelve months.

Under certain circumstances, the Company may be required to return a portion or all the distributions it received as a general partner of certain private equity funds (the "clawback"). Assuming the private equity funds in which the Company was a general partner were liquidated or dissolved on June 30, 2007 and assuming for these purposes the only distributions from the funds were equal to the carrying value of the funds on the June 30, 2007 financial statements, the maximum clawback the Company would be required to return for its general partner interest is approximately \$8 million. The Company estimates its liability to be approximately \$6.7 million of which \$5.3 million was reflected in Accrued Expenses and Other Current Liabilities and \$1.4 million was reflected in Other Long-Term Liabilities on the Consolidated Balance Sheets.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**
Cautionary Note concerning Forward-Looking Statements

This report contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about us, 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, may, variations of such words or other words that convey uncertainty of future events or outcomes, we are making forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Our forward-looking statements are subject to risks and uncertainties. Factors that could cause actual results to differ materially, include, among others, managing rapidly changing technologies, limited access to capital, competition, the ability to attract and retain qualified employees, the ability to execute our strategy, the uncertainty of the future performance of our partner companies, acquisitions and dispositions of interests in partner companies, the inability to manage growth, compliance with government regulation and legal liabilities, additional financing requirements and the effect of economic conditions in the business sectors in which our partner companies operate, all of which are discussed below under the heading Factors that May Affect Future Results, in Item 1A in Safeguard's Annual Report on Form 10-K and updated, as applicable, in Item 1A Risk Factors below. Many of these factors are beyond our ability to predict or control. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report might not occur. 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.

Overview

Safeguard's charter is to build value in growth-stage technology and life sciences businesses. We provide growth capital as well as a range of strategic, operational and management resources to our partner companies. Safeguard participates in expansion financings, carve-outs, management buy-outs, recapitalizations, industry consolidations and early-stage financings. Our vision is to be the preferred catalyst for creating great technology and life sciences companies.

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

Technology including companies focused on providing software as a service (SaaS), technology-enabled services and vertical software solutions for analytics, enterprise application, infrastructure, security and communication; and

Life Sciences including companies focused on medical devices, molecular diagnostics, drug delivery and specialty pharmaceuticals.

Principles of Accounting for Ownership Interests in Partner Companies

The various interests that we acquire in our partner companies and private equity funds are accounted for under three methods: consolidation, equity or cost. The applicable accounting method is generally determined based on our influence over the entity, primarily determined based on our voting interest in the entity.

Consolidation Method. Partner companies in which we directly or indirectly own more than 50% of the outstanding voting securities are accounted for under the consolidation method of accounting. Participation of other partner company shareholders in the income or losses of our consolidated partner companies is reflected as Minority Interest in the Consolidated Statements of Operations. Minority interest adjusts our consolidated operating results to reflect only our share of the earnings or losses of a consolidated partner company. If there is no minority interest balance remaining on the Consolidated Balance Sheets related to a partner company, we record 100% of the respective consolidated partner company's losses. We record 100% of that partner company's subsequent income, if any, to the

extent of such previously recognized losses in excess of our proportionate share.

Table of Contents

Equity Method. The partner companies whose results are not consolidated, but over whom we exercise significant influence, are accounted for under the equity method of accounting. We also account for our interests in some private equity funds under the equity method of accounting, based on our respective general and limited partner interests. Under the equity method of accounting, our share of the income or loss of the company is reflected in Equity Loss in the Consolidated Statements of Operations. We report our share of the income or loss of the equity method partner companies on a one quarter lag.

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

Cost Method. Partner companies not consolidated or accounted for under the equity method are accounted for under the cost method of accounting. Under the cost method, our share of the income or losses of such entities is not included in our Consolidated Statements of Operations. The effect of the change in market value of cost method holdings classified as trading securities is reflected in Other Income (Loss), Net in the Consolidated Statements of Operations.

Critical Accounting Policies and Estimates

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

Revenue recognition;

Recoverability of long-lived assets;

Recoverability of goodwill;

Recoverability of ownership interests in and advances to companies;

Income taxes;

Commitments and contingencies; and

Stock-based compensation.

Revenue Recognition

During the three and six months ended June 30, 2007 and 2006, our revenue from continuing operations was attributable to Acsis, Alliance Consulting, Clariant and Laureate Pharma.

Acsis generates revenue from (i) software fees, which consist of revenue from the licensing of software, (ii) services revenue, which consist of fees from consulting, implementation and training services, plus customer support services, and (iii) hardware and reimbursed project expenses. Acsis recognizes software fees in accordance with Statement of Position No. 97-2, Software Revenue Recognition (SOP 97-2), as amended. Acsis recognizes software license revenue when the following criteria are met: (1) a signed contract is obtained; (2) delivery of the products has occurred; (3) the license fee is fixed or determinable; and (4) collectibility is probable. Acsis generally recognizes license revenue using the residual method when there is vendor-specific objective evidence of the fair values of all undelivered elements in a multiple-element arrangement that is not accounted for using long-term contract accounting. For those contracts that contain significant customization or modifications, license revenue is

recognized using the percentage-of-completion method. Acsis recognizes revenues from professional consulting services under fixed-price arrangements, using the proportional-performance method based on direct labor costs incurred to date as a percentage of total estimated labor costs required to complete the project. Project losses are provided for in their entirety in the period they become known, without regard to the percentage-of-completion. Acsis recognizes hardware revenue upon shipment by the vendor to the customer unless the hardware is an element in an arrangement that includes services that involve significant customization or modifications to software, in which case, hardware revenue is bundled with the software and services are recognized on a percentage-of-completion basis.

Alliance Consulting generates revenue primarily from consulting services. Alliance Consulting generally recognizes revenue when persuasive evidence of an arrangement exists, services are performed, the service fee is fixed or determinable

Table of Contents

and collectibility is probable. Revenue from services is recognized as services are performed. Alliance Consulting also performs certain services under fixed-price service contracts related to discrete projects. Alliance Consulting recognizes revenue from these contracts using the percentage-of-completion method, primarily based on the actual labor hours incurred to date compared to the estimated total hours of the project. Any losses expected to be incurred on jobs in process are charged to income in the period such losses become known. Changes in estimates of total costs could result in changes in the amount of revenue recognized.

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

Laureate Pharma's revenue is primarily derived from contract manufacturing work, process development services, and formulation and filling. Laureate Pharma may enter into revenue arrangements with multiple deliverables in order to meet its customers' needs. Multiple element revenue agreements are evaluated under Emerging Issues Task Force (EITF) Issue Number 00-21, Revenue Arrangements with Multiple Deliverables, to determine whether the delivered item has value to the customer on a stand-alone basis and whether objective and reliable evidence of the fair value of the undelivered item exists. Deliverables in an arrangement that do not meet the separation criteria in EITF 00-21 are treated as one unit of accounting for purposes of revenue recognition. Revenue is generally recognized upon the performance of services. Certain services are performed under fixed price contracts. Revenue from these contracts is recognized on a percentage of-completion basis. When current cost estimates indicate a loss is expected to be incurred, the entire loss is recorded in the period in which it is identified. Changes in estimates of total costs could result in changes in the amount of revenue recognized.

Recoverability of Long-Lived Assets

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

The carrying value of net intangible assets at June 30, 2007 was \$10.9 million. The carrying value of net property and equipment at June 30, 2007 was \$35.4 million.

Recoverability of Goodwill

We conduct a review for impairment of goodwill annually on December 1st. Additionally, on an interim basis, we assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that we consider important which could trigger an impairment review include significant underperformance relative to historical or expected future operating results, significant changes in the manner or use of the acquired assets or the strategy for the overall business, divestiture of all or part of the business, significant negative industry or economic trends or a decline in a company's stock price for a sustained period.

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

The carrying value of goodwill at June 30, 2007 was \$82.5 million.

Table of Contents

Our partner companies operate in industries which are rapidly evolving and extremely competitive. It is reasonably possible that our accounting estimates with respect to the ultimate recoverability of the carrying value of goodwill could change in the near term and that the effect of such changes on our Consolidated Financial Statements could be material. While we believe that the current recorded carrying value of our goodwill is not impaired, there can be no assurance that a significant write-down or write-off will not be required in the future. Impairment charges related to goodwill of consolidated partner companies are included in Goodwill Impairment in the Consolidated Statements of Operations.

Recoverability of Ownership Interests In and Advances to Companies

On a continuous basis (but no less frequently than at the end of each quarterly period) we evaluate the carrying value of our equity and cost method companies for possible impairment based on achievement of business plan objectives and milestones, the fair value of each company relative to its carrying value, the financial condition and prospects of the company and other relevant factors. We then determine whether there has been an other than temporary decline in the carrying value of our ownership interest in the company. Impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds the fair value of the assets.

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

The new cost basis of a company is not written-up if circumstances suggest the value of the company has subsequently recovered.

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

Income Taxes

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

Commitments and Contingencies

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

analysis of each matter. The provision may change in the future due to new developments or changes in circumstances. Changes in the provision could increase or decrease our earnings in the period the changes are made.

Table of Contents**Stock-based Compensation**

On January 1, 2006, we adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)). SFAS No. 123(R) requires companies to measure all employee stock-based compensation awards using a fair value method and to record such expense in its consolidated financial statements.

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

Results of Operations

We present our consolidated partner companies as separate segments Acsis, Alliance Consulting, Clariant and Laureate Pharma. The results of operations of our other partner companies in which we have less than a majority interest and our ownership in private equity funds are reported in a segment called Other Companies. This segment also includes the gain or loss on the sale of companies and funds, except for gains and losses included in discontinued operations.

Our management evaluates segment performance based on segment revenue, operating income (loss) and income (loss) before income taxes, which reflects the portion of income (loss) allocated to minority shareholders.

Other items includes certain expenses which are not identifiable to the operations of our operating business segments. Other items primarily consists of general and administrative expenses related to our corporate operations, including employee compensation, insurance and professional fees, including legal, finance and consulting. Other items also includes interest income, interest expense and income taxes, which are reviewed by management independent of segment results.

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

The Company's operating results including net income (loss) before income taxes by segment were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Acsis	\$ (2,227)	\$ (1,776)	\$ (4,867)	\$ (3,905)
Alliance Consulting Alliance	(1,437)	(828)	(3,096)	(1,314)
Clariant	(1,473)	(1,834)	(3,430)	(3,873)
Laureate Pharma	(547)	(2,634)	(2,336)	(4,964)
Other companies	(4,250)	(958)	(5,979)	350
Total segments	(9,934)	(8,030)	(19,708)	(13,706)
Other items				
Corporate operations	(4,320)	(4,921)	(9,478)	(9,054)
Income tax benefit (expense)	710	1,284	696	1,275

Edgar Filing: SAFEGUARD SCIENTIFICS INC - Form 10-Q

Total other items	(3,610)	(3,637)	(8,782)	(7,779)
Net (loss) from continuing operations	(13,544)	(11,667)	(28,490)	(21,485)
Net income (loss) from discontinued operations	(21)	2,432	3,260	5,798
Net Loss	\$ (13,565)	\$ (9,235)	\$ (25,230)	\$ (15,687)

27

Table of Contents

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

Acsis

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Revenue	\$ 5,140	\$ 4,584	\$ 9,355	\$ 8,985
Operating expenses:				
Cost of sales	3,743	3,236	6,986	6,494
Selling, general and administrative	2,836	2,407	5,312	4,778
Research and development	509	441	1,381	1,081
Amortization of intangibles	263	384	526	760
Total operating expenses	7,351	6,468	14,205	13,113
Operating loss	(2,211)	(1,884)	(4,850)	(4,128)
Interest, net	(16)	4	(17)	10
Minority interest	--	104	--	213
Net loss before income taxes	\$ (2,227)	\$ (1,776)	\$ (4,867)	\$ (3,905)

Acsis is a leading provider of software and service solutions that assist manufacturing companies in improving efficiencies throughout the entire supply-chain. Its solutions enable manufacturers to automate plant floor/warehouse operations and take advantage of emerging automated-ID technologies, including radio frequency identification (RFID) and barcode.

Acsis draws from a variety of technologies and service offerings to create a solution that matches the client's business, budget and IT environment. Solutions range from the next generation of shop floor process automation and data collection using their xDDi enterprise solution suite, Enterprise Label Management, which enables users to design and generate customer-specific label forms directly for SAP ERP data and manage from a central location, and Line Manager, an intelligent appliance to support RFID and barcode-based product tracking for warehouse, manufacturing, packing and shipping operations, and value-added services for implementing SAPConsole and xMII. If requested, Acsis will provide all necessary hardware, consulting services and software to deliver a turnkey data-collection / supply chain solution.

Acsis' competition generally comes from large, diversified software or consulting businesses or niche providers with a variety of individual solutions for barcode, RFID or other data collection systems. Acsis differentiates itself by providing a single, integrated platform which can be used across the entire supply chain to increase efficiencies and reduce operational costs.

Acsis' revenue is derived from (i) software fees, which consist of revenue from the licensing of software, (ii) services revenue, which consist of fees from consulting, implementation and training services, plus customer support services; and (iii) hardware and reimbursed project expenses.

At June 30, 2007, we owned a 96% voting interest in Acsis.

Three months ended June 30, 2007 versus three months ended June 30, 2006

Revenue. Revenue increased \$0.6 million or 12.1% in 2007 as compared to the prior year period. The increase was primarily due to a \$0.4 million increase in services revenue and a \$0.1 million increase in license revenue. The increase in 2007 services revenue was driven by customer services related to license agreements signed during late 2006.

Cost of Sales. Cost of sales increased \$0.5 million, or 15.7% in 2007 as compared to the prior year period. The increase is primarily due to an increase in service costs related to additional resources needed for the implementation of several projects. Gross margins were 27.2% and 29.4% for the three months ended June 30, 2007 and 2006, respectively.

Table of Contents

Gross margins declined 2.2% in 2007 as compared to the prior year period due to additional resources needed in the first half of 2007 related to the implementation of several projects. Gross margins are expected to modestly improve in the second half of 2007 as compared to the first half of 2007 due to expected operating efficiencies.

Selling, General and Administrative. Selling, general and administrative expenses increased \$0.4 million or 17.8% as compared to the prior year period. Selling, general and administrative expenses were 55.2% of revenue in 2007 and 52.5% of revenue in 2006. The increase was primarily attributable to higher professional fees and severance costs.

Research and Development. Research and development expenses increased \$0.1 million or 15.4% in 2007 as compared to the prior year period. The increase was a result of costs associated with the development of new product offerings.

Amortization of Intangibles. Amortization of intangibles decreased \$0.1 million or 31.5% as compared to the prior year period. The decrease was due to an intangible asset with a life of one year that was fully amortized in 2006.

Net Loss Before Income Taxes. Net loss increased \$0.5 million or 25.4% as compared to the prior year period. The increase was attributable to higher cost of sales, selling general and administrative expenses, and research and development expenses, that were not fully offset by increased revenue.

Six months ended June 30, 2007 versus six months ended June 30, 2006

Revenue. Revenue increased \$0.4 million or 4.1% in 2007 as compared to the prior year period. The increase was due to a \$0.7 million increase in services revenue. The higher services revenue was due to a \$0.4 million increase in customer support services and a \$0.3 million increase in consulting revenue, both driven by certain license agreements signed during late 2006, partially offset by a \$0.5 million decline in hardware revenue. Hardware sales fluctuate significantly from period to period due to the timing of customer orders.

Cost of Sales. Cost of sales increased \$0.5 million or 7.6% in 2007 as compared to the prior year period. The increase is primarily due to an increase in service costs, partially offset by a decline in hardware costs. The decrease in hardware costs was directly attributed to the decrease in hardware sales volume, while the increase in service costs was a result of additional resources related to the implementation of several projects. Gross margins were 25.3% and 27.7% for the six months ended June 30, 2007 and 2006, respectively. Gross margins declined 2.4% in 2007 as compared to the prior year period due to additional resources needed in the first half of 2007 related to the implementation of several projects.

Selling, General and Administrative. Selling, general and administrative expenses increased \$0.5 million or 11.2% in 2007 as compared to the prior year period. Selling, general and administrative expenses were 56.8% of revenue in 2007 and 53.2% of revenue in 2006. The increase was primarily attributable to additional professional fees and severance costs associated with a reduction in workforce during 2007.

Research and Development. Research and development expenses increased \$0.3 million or 27.8% in 2007 as compared to the prior year period. The increase was a result of costs associated with the development of new product offerings.

Amortization of Intangibles. Amortization of intangibles decreased \$0.2 million or 30.8% as compared to the prior year period. The decrease was due to an intangible asset with a life of one year that was fully amortized in 2006.

Net Loss Before Income Taxes. Net loss increased \$1.0 million or 24.6% as compared to the prior year period. The increase was attributable to higher cost of sales, selling general and administrative expenses, and research and development expenses, that were not fully offset by increased revenue.

Alliance Consulting

Alliance Consulting operates on a 52 or 53-week fiscal year, ending on the Saturday closest to the end of the fiscal period. Alliance Consulting's second quarter ended on June 30, 2007 and July 1, 2006, each a period of 13 weeks, and year-to-date a period of 26 weeks, respectively. The financial information presented below does not include the results of operations of Alliance Consulting's Southwest region business, which is included in discontinued operations for the periods prior to its sale. Alliance Consulting completed the sale of that business during the second quarter of 2006, which resulted in

Table of Contents

a net gain of \$1.6 million. The Southwest region business generated revenue of \$1.0 million and \$3.1 million, with net income of \$1.7 million, for both the three and six months ended July 1, 2006, respectively.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Revenue	\$ 21,393	\$ 25,868	\$ 42,850	\$ 51,080
Operating expenses:				
Cost of sales	15,860	18,377	31,840	36,645
Selling, general and administrative	6,503	7,926	13,232	14,898
Amortization of intangibles	262	243	523	487
Total operating expenses	22,625	26,546	45,595	52,030
Operating loss	(1,232)	(678)	(2,745)	(950)
Other income, net	41	9	43	19
Interest, net	(259)	(159)	(419)	(383)
Minority interest	13	--	25	--
Net loss before income taxes	\$ (1,437)	\$ (828)	\$ (3,096)	\$ (1,314)

Alliance Consulting is a leading national business intelligence consultancy providing services primarily to Fortune 2000 clients in the pharmaceutical, financial services and manufacturing industries. Alliance Consulting specializes in information management, which is comprised of a full range of business intelligence solutions from data acquisition and warehousing to master data management, analytics and reporting, and application services, which includes software development, integration, testing and application support delivered through a high quality and cost effective hybrid global delivery model. Alliance Consulting has developed a strategy focused on enabling business intelligence through the application of deep domain experience and custom-tailored project teams to deliver software solutions and consulting services.

While global economic conditions continue to cause companies to be cautious about increasing their use of consulting and IT services, Alliance Consulting expects to see stable demand for its services. However, Alliance Consulting continues to experience pricing pressure from competitors as well as from clients facing pressure to control costs. In addition, the growing use of offshore resources to provide lower cost service delivery capabilities within the industry continues to place pressure on pricing and revenue. Alliance Consulting expects to continue to focus on maintaining and growing its blue chip client base and providing high quality solutions and services to its clients.

In July 2006, Alliance Consulting completed the purchase of specific assets and assumed certain liabilities of Fusion Technologies, Inc., (Fusion) a provider of strategic information technology solutions to rapidly growing organizations within the United States, increasing Alliance Consulting's substantial offshore capabilities for new and existing clients.

At June 30, 2007, we owned 99% of Alliance Consulting.

Three months ended June 30, 2007 versus three months ended June 30, 2006

Revenue. Revenue, including reimbursement of expenses, decreased \$4.5 million, or 17.3% in 2007 as compared to the prior year period. This decrease was due to the completion of several significant contracts and the deferral of several new engagements. Recently, Alliance Consulting developed and is implementing its second half improvement plan, which includes improving sales team productivity, implementing expense and delivery

management improvements, and discontinuing lower margin projects.

Cost of Sales. Cost of sales decreased \$2.5 million, or 13.7% in 2007 as compared to the prior year period. This decrease was primarily a result of the decline in revenue. Gross margins were 25.8% and 29.0% for the three months ended June 30, 2007 and 2006, respectively. Gross margins declined 3.2% in 2007 as compared to the prior year period due to the decline in revenue and the fixed nature of certain costs. Alliance Consulting expects gross margins to continue to be affected by general economic uncertainty, increases in overall pricing pressures within the industry, discounts required for longer-term engagements, and increased employee and contractor costs. The increased employee and contractor costs have resulted from greater competition within the talent pool due to declining unemployment levels, wage inflation in India as the demand for those resources increases, resource availability, and the ability to retain key resources. Alliance expects gross margins to

Table of Contents

slightly improve in the second half of 2007 as compared to the first half of 2007 due to the completion of certain lower margin engagements, and expected replacement with more profitable projects.

Selling, General and Administrative. Selling, general and administrative expenses decreased \$1.4 million, or 17.9% in 2007 as compared to the prior year period. Selling, general and administrative expenses were 30.4% of revenue in 2007 versus 30.6% of revenue for the prior year period. The decrease was primarily due to a restructuring charge of \$0.5 million to consolidate multiple facilities within the same geographic market and severance costs of approximately \$0.3 million recognized during the prior year period. Also contributing to the decrease is the decline in variable compensation as a result of decreased operating results during the second quarter of 2007. Selling, general and administrative costs are expected to remain flat for the remainder of 2007, though are expected to decrease as a percentage of revenue due to expected revenue growth during the second half of 2007 as compared to the first half of 2007.

Interest, Net. Interest expense increased \$0.1 million or 62.9% in 2007 as compared to the prior year period primarily as a result of higher average outstanding borrowings under the credit facility and an increase in interest rates.

Net Loss Before Income Taxes. Net loss increased \$0.6 million or 73.6% in 2007 as compared to the prior year period. The increase was primarily related to the decrease in revenue, partially offset by decreases in cost of sales and selling, general and administrative expenses.

Six months ended June 30, 2007 versus six months ended June 30, 2006

Revenue. Revenue, including reimbursement of expenses, decreased \$8.2 million, or 16.1% in 2007 as compared to the prior year period. This decrease was due to delays by customers in starting projects and the completion of several significant contracts. Recently, Alliance Consulting developed and is implementing its second half improvement plan, which includes improving sales team productivity, aggressively implementing expense and delivery management improvements, and discontinuing lower margin projects.

Cost of Sales. Cost of sales decreased \$4.8 million, or 13.1% in 2007 as compared to the prior year period. This decrease was primarily a result of the decline in revenue. Gross margins were 25.3% and 27.7% for the six months ended June 30, 2007 and 2006, respectively. Gross margins declined 2.4% in 2007 as compared to the prior year period due to the decline in revenue and the fixed nature of certain costs.

Selling, General and Administrative. Selling, general and administrative expenses decreased \$1.7 million, or 11.2% in 2007 as compared to the prior year period. The decrease in dollars was due a restructuring charge of \$0.5 million to consolidate multiple facilities within the same geographic market and severance costs of approximately \$0.3 million recognized during the prior year period. Also contributing to the decrease is the decline in variable compensation as a result of decreased performance in 2007. Selling, general and administrative expenses were 30.9% of revenue in 2007 as compared to 29.2% of revenue in 2006.

Interest, Net. Interest expense increased slightly in 2007 as compared to the prior year period due to higher average outstanding borrowings and an increase in interest rates.

Net Loss Before Income Taxes. Net loss increased \$1.8 million or 135.6% in 2007 as compared to the prior year period. The increase was primarily related to the decrease in revenue, partially offset by decreases in cost of sales and selling, general and administrative expenses.

Clariant

The financial information presented below does not include the results of operations of Clariant's technology group business, which is included in discontinued operations for all periods presented. Clariant sold this business (which developed, manufactured and marketed the ACIS Automated Image Analysis System) and related intellectual property to Carl Zeiss MicroImaging, Inc. (the ACIS Sale) for net cash proceeds of \$10.3 million, excluding contingent purchase price of \$1.5 million. In the first quarter of 2007, prior to its sale, the technology group business generated revenue of \$0.8 million, net loss from operations of \$0.6 million and a gain on disposal of \$3.6 million. The technology group business generated revenue of \$1.1 million and \$2.4 million, with net loss from operations of \$0.9 million and \$1.5 million for the three and six months ended June 30, 2006.

Table of Contents

	Three Months Ended		Six Months Ended June 30,	
	June 30,		2007	2006
	2007	2006	2007	2006
	(In thousands)			
Revenue	\$ 10,336	\$ 6,366	\$ 19,193	\$ 11,881
Operating expenses:				
Cost of sales	5,519	3,444	10,616	6,719
Selling, general and administrative	7,126	6,077	14,152	11,976
Total operating expenses	12,645	9,521	24,768	18,695
Operating loss	(2,309)	(3,155)	(5,575)	(6,814)
Other loss, net	(44)	--	--	--
Interest, net	(237)	(78)	(611)	(98)
Minority interest	1,117	1,399	2,756	3,039
Net loss before income taxes	\$ (1,473)	\$ (1,834)	\$ (3,430)	\$ (3,873)

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

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

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

As of June 30, 2007, we owned a 60% voting interest in Clariant.

Three months ended June 30, 2007 versus three months ended June 30, 2006

Revenue. Revenue increased \$4.0 million, or 62.4% in the second quarter of 2007 as compared to the prior year period. This increase resulted from the execution of Clariant's marketing and sales strategy to increase sales to new customers and to enter into new managed care contracts. This increase was also driven in part by increasing the number of available tests performed to include immunohistochemistry, flow cytometry and fluorescent in situ hybridization (FISH). Clariant anticipates that revenue will continue to increase as a result of increased revenue from existing customers, additions of new customers (including managed care providers) by Clariant's sales force, and its offering of a more comprehensive suite of advanced cancer diagnostic tests.

Cost of Sales. Cost of sales increased \$2.1 million, or 60.2% in the second quarter of 2007 as compared to the prior year period. These costs included laboratory personnel, lab-related depreciation expense, laboratory supplies and other direct costs such as shipping. Gross margin in the second quarter of 2007 was 46.6%, compared to 45.9% in the prior year period. The 0.7% increase in gross margin in the second quarter of 2007 was attributable to achieving economies of scale within operations. Clariant anticipates similar or improving gross margins during the second half of 2007.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased \$1.0 million, or 17.3% in the second quarter of 2007, as compared to the prior year period. As a percentage of revenue, these expenses decreased to 68.9% for the second quarter of 2007 from 95.4% in the prior year period. The

increase in expenses for the second quarter 2007 was primarily due to increases in variable costs to generate and support revenue growth and to improve infrastructure including selling and marketing expenses, billing and collection costs, and facility overhead to expand service capacity. In addition, Clariant increased headcount and consulting resources in information technology to support future revenue growth during the second quarter of 2007 and incurred incremental stock-based compensation expense due to the mark-to-market of stock options granted to non-employees. Clariant anticipates selling expenses will continue to grow in the second half of 2007 to support its expected revenue growth, but expects general and administrative expenses to decline as a percentage of revenues as infrastructure costs stabilize.

Interest, Net. Interest expense for the second quarter of 2007 increased \$0.2 million compared to the prior year period, primarily due to higher average outstanding borrowings under Clariant's financing facilities.

Table of Contents

Net Loss Before Income Taxes. Net loss before income taxes decreased \$0.4 million, or 19.7% in the second quarter of 2007 compared to the prior year period, primarily due to higher revenue and improved gross margins, partially offset by higher selling, general and administrative expenses and interest expense.

Six months ended June 30, 2007 versus six months ended June 30, 2006

Revenue. Revenue increased \$7.3 million, or 61.5% in 2007 as compared to the prior year period. This increase resulted from the execution of Clariant's marketing and sales strategy to increase sales to new customers and to enter into new managed care contracts. This increase was also driven in part by increasing the number of available tests performed to include immunohistochemistry, flow cytometry and fluorescent in situ hybridization (FISH).

Cost of Sales. Cost of sales increased \$3.9 million, or 58.0% in 2007 as compared to the prior year period. These costs included laboratory personnel, lab-related depreciation expense, laboratory supplies and other direct costs such as shipping. Gross margin in the first half of 2007 was 44.7%, compared to 43.4% in the prior year period. The 1.3% increase in gross margin during the first half of 2007 was attributable to achieving economies of scale within operations.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased \$2.2 million, or 18.2% during the first half of 2007, as compared to the prior year period. As a percentage of revenue, these expenses decreased to 73.7% for first half of 2007 from 100.8% in the prior year period. The increase in expenses during the first half of 2007 was primarily due to increases in variable costs to generate and support revenue growth and to improve infrastructure including selling and marketing expenses, billing and collection costs, and facility overhead to expand service capacity. In addition, Clariant increased headcount and consulting resources in information technology to support future revenue growth during the first half of 2007 and incurred incremental stock-based compensation expense due to the mark-to-market of stock options granted to non-employees. Clariant anticipates selling expenses will continue to grow in the second half of 2007 to support its expected revenue growth, but expects general and administrative expenses to decline as a percentage of revenues as infrastructure costs stabilize.

Interest, Net. Interest expense for the first half of 2007 increased \$0.5 million compared to the prior year period, primarily due to higher average outstanding borrowings under Clariant's financing facilities.

Net Loss Before Income Taxes. Net loss before income taxes decreased \$0.4 million, or 11.4% in the first half of 2007 compared to the prior year period, primarily due to higher revenue and improved gross margins, partially offset by higher selling, general and administrative expenses and interest expense.

Laureate Pharma

	Three Months		Six Months Ended June 30,	
	Ended June 30,	2006	2007	2006
	2007			
	(In thousands)			
Revenue	\$ 6,863	\$ 2,468	\$ 11,843	\$ 4,646
Operating expenses:				
Cost of sales	5,796	3,676	10,851	6,917
Selling, general and administrative	1,353	1,270	2,868	2,451
Total operating expenses	7,149	4,946	13,719	9,368
Operating loss	(286)	(2,478)	(1,876)	(4,722)
Interest, net	(261)	(156)	(460)	(242)
Net loss before income taxes	\$ (547)	\$ (2,634)	\$ (2,336)	\$ (4,964)

Laureate Pharma is a full-service Contract Manufacturing Organization (CMO) providing critical development and Current Good Manufacturing Practices (cGMP) manufacturing services. Laureate Pharma seeks to become a leader in this segment of the biopharmaceutical industry by delivering superior development and manufacturing services to its customers.

Laureate Pharma's broad range of services includes: bioprocessing, aseptic filling, quality control and quality assurance. Laureate Pharma provides process development and manufacturing services on a contract basis to biopharmaceutical companies. Laureate Pharma operates a facility in Princeton, New Jersey.

Table of Contents

Laureate Pharma's customers generally include biotechnology and pharmaceutical companies seeking outsourced bioprocessing manufacturing and development services. Laureate Pharma's customers are often dependent on the availability of funding to pursue drugs that are in early stages of clinical trials, and thus have high failure rates. The loss of one or more customers can result in significant swings in profitability from quarter to quarter and year to year. Although there has been a trend among biopharmaceutical companies to outsource drug production functions, this trend may not continue. Laureate Pharma's customer contracts are generally for periods of one to two years. As a result, Laureate Pharma seeks new contracts to sustain its revenue.

As of June 30, 2007, we owned a 100% voting interest in Laureate Pharma.

Three months ended June 30, 2007 versus three months ended June 30 2006

Revenue. Revenue increased \$4.4 million, or 178.1% in 2007 as compared to the prior year period. The increase was due to a \$3.0 million increase in manufacturing revenue, a \$0.8 million increase in reimbursement from customers for materials, \$0.6 million increase in aseptic filling, a \$0.2 million increase in process development, partially offset by a \$0.2 million decrease in support services revenue. Revenue is expected to remain consistent during the second half of 2007 as compared to the first half of 2007.

Cost of Sales. Cost of sales increased \$2.1 million, or 57.7% in 2007 as compared to the prior year period. The increase was due to an increase in production volume, including a \$0.8 million increase in direct materials and lab supplies, a \$0.8 million increase in reimbursable expenses for specific customer materials, and a \$0.5 million increase in compensation expense resulting from additional staffing requirements. Gross margins were 15.5% and (48.9)% for the three months ended June 30, 2007 and June 30, 2006, respectively. The improvement in gross margins in 2007 as compared to the prior year period is primarily due to increased manufacturing and filling revenues and the fixed nature of certain costs. Laureate expects gross margins to modestly improve during the second half of 2007 as compared to the first half of 2007 due to the expected delivery of services that provide higher margins.

Selling, General and Administrative. Selling, general, and administrative expenses increased \$0.1 million, or 6.5% in 2007 as compared to the prior year period. The increase was due to increased compensation expense of \$0.1 million resulting from additional staffing and a \$0.1 million increase in administrative support costs, partially offset by a \$0.1 million decrease in marketing expenses. Selling, general and administrative expenses were 19.7% of revenue in the second quarter of 2007 as compared to 51.5% in the prior year period. Selling, general and administrative expenses are expected to slightly increase during the second half of 2007 as compared to the first half of 2007 due to additional marketing activities and administrative support costs.

Interest, Net. Interest expense increased \$0.1 million in 2007 as compared to the prior year period. The increase was primarily a result of higher average outstanding borrowings.

Net Loss Before Income Taxes. Net loss decreased \$2.1 million, or 79.2% in 2007 as compared to the prior year period. The decline in net loss was primarily attributable to increased revenues.

Six months ended June 30, 2007 versus six months ended June 30, 2006

Revenue. Revenue increased \$7.2 million, or 154.9% in 2007 as compared to the prior year period. The increase was due to a \$4.4 million increase in manufacturing revenues, a \$1.3 million increase in reimbursable expenses and a \$1.0 million increase in aseptic filling, partially offset by a \$0.5 million decrease in support services.

Cost of Sales. Cost of sales increased \$3.9 million, or 56.9% in 2007 as compared to the prior year period. The increase is due to a \$1.3 million increase in direct materials and lab supplies, a \$1.2 million increase in reimbursable expenses for specific customer materials, a \$1.0 million increase in compensation expense resulting from additional staffing requirements, and a \$0.4 million increase in other production support costs resulting from higher customer activity. Gross margins were 8.4% and (48.9)% for the six months ended June 30, 2007 and June 30, 2006, respectively. The improvement in gross margins in 2007 as compared to the prior year period is primarily due to increased manufacturing and filling revenues and the fixed nature of certain costs.

Table of Contents

Selling, General and Administrative. Selling, general and administrative expenses increased \$0.4 million, or 17.0% in 2007 as compared to the prior year period. The increase was due to increased compensation expense of \$0.3 million resulting from additional staffing, and increased administrative support costs of \$0.2 million, partially offset by a \$0.1 million decrease in marketing expenses.

Interest, Net. Interest expense increased \$0.2 million in 2007 as compared to the prior year period. The increase was primarily a result of higher average outstanding borrowings.

Net Loss Before Income Taxes. Net loss decreased \$2.6 million, or 52.9% in 2007 as compared to the prior year period. The decline in net loss was primarily attributable to increased revenues.

Other Companies

	Three Months Ended		Six Months Ended June 30,	
	June 30,	June 30,	June 30,	June 30,
	2007	2006	2007	2006
	(In thousands)			
Other income (loss), net	\$ (800)	\$ (1,293)	\$ (800)	\$ 620
Equity income (loss)	(3,450)	335	(5,179)	(270)
Net income (loss) before income taxes	\$ (4,250)	\$ (958)	\$ (5,979)	\$ 350

Other Income (Loss), Net

	Three Months		Six Months Ended June 30,	
	Ended June 30,	Ended June 30,	June 30,	June 30,
	2007	2006	2007	2006
	(In thousands)			
Gain on sale of companies and funds, net	\$ --	\$ --	\$ --	\$ 1,181
Loss on trading securities	--	(1,261)	--	(532)
Impairment	(800)	--	(800)	--
Other	--	(32)	--	(29)
	\$ (800)	\$ (1,293)	\$ (800)	\$ 620

Gain on sale of companies and funds of \$1.2 million for the six months ended June 30, 2006 related to the sale of holdings in a cost method company whose carrying value was zero.

Loss on trading securities in 2006 primarily reflects the adjustment to fair value of our holdings in Traffic.com. We sold our holdings in Traffic.com in the fourth quarter of 2006.

We recorded an impairment charge of \$0.8 million in the second quarter of 2007 for a cost method partner company determined to have experienced an other-than-temporary decline in value in accordance with our policy regarding impairment of ownership interests in and advances to companies.

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

The increase in equity loss in the three and six months ended June 30, 2007 compared to the prior year periods is due to an increase in the number of our equity method partner companies. During the second half of 2006, we acquired interests in four companies accounted for under the equity method: Advantedge Healthcare Solutions,

NuPathe, Portico Systems and Rubicor Medical. During the first half of 2007, we acquired interests in three additional companies accounted for under the equity method: Advanced BioHealing, Beyond.com, and Cellumen. Each of these companies incurred losses for which we recognized our proportionate share in the three and six months ended June 30, 2007. New holdings in growth-stage companies have led, and are expected to continue to lead to, larger equity losses until those companies reach scale and achieve profitability.

Table of Contents**Corporate Operations**

	Three Months Ended		Six Months Ended June 30,	
	June 30,		2007	2006
	2007	2006	2007	2006
	(In thousands)			
General and administrative costs, net	\$ (4,378)	\$ (4,241)	\$ (9,645)	\$ (8,684)
Stock-based compensation	(1,087)	(1,101)	(2,094)	(2,260)
Interest income	2,142	1,555	4,260	3,037
Interest expense	(1,053)	(1,190)	(2,110)	(2,404)
Other	56	56	111	1,257
	\$ (4,320)	\$ (4,921)	\$ (9,478)	\$ (9,054)

General and Administrative Costs, Net. Our general and administrative expenses consist primarily of employee compensation, insurance, professional fees such as legal, accounting and consulting, and travel-related costs. The increase of \$0.1 million during the second quarter of 2007 as compared to the second quarter of 2006 relates to an increase of \$0.1 million in employee related costs due to new hires to support Safeguard's long-term strategy. General and administrative costs increased \$1.0 million for the six month period 2007 as compared to the prior year period primarily due to an increase of \$0.4 million in employee related costs due to new hires to support Safeguard's long-term strategy, as well as an increase in professional fees of \$0.6 million.

We expect full year corporate selling, general and administrative expenses to continue to be moderately higher in 2007 as compared to the prior year.

Stock-Based Compensation. Stock-based compensation consists primarily of expense related to stock option grants and grants of restricted stock and deferred stock units to our employees. The \$0.2 million decrease for the six months ended June 30, 2007, as compared to the prior year period is primarily attributable to lower expense related to market-based awards in 2007. Stock based compensation expense related to corporate operations is included in Selling, general and administrative in the Consolidated Statements of Operations.

Interest Income. Interest income includes all interest earned on available cash balances. Interest income increased \$0.6 million and \$1.2 million for the three and six months of 2007, respectively, as compared to 2006. This net increase is attributable to higher interest rates on higher invested cash balances in 2007 as compared to 2006.

Interest Expense. Interest expense is primarily related to our 2.625% convertible senior debentures with a stated maturity of 2024. Interest expense decreased for the three and six months ended June 30, 2007 as compared to the prior year periods due to the repurchase of \$21 million of face value of the 2024 Debentures in 2006.

Other. Included in the six months ended June 30, 2006 is a net gain of \$1.1 million on the repurchase of \$5 million of face value of the 2024 Debentures.

Income Tax Benefit

Our consolidated net income tax benefit was \$0.7 million for the three and six months ended June 30, 2007 and \$1.3 million for the three and six months ended June 30, 2006. The tax benefits primarily related to uncertain tax positions for which the statutes of limitations expired during the periods in the applicable tax jurisdictions. We also recognized tax expense of \$0.1 million and \$0.2 million in the three and six months ended June 30, 2006, respectively, related to our share of net state and foreign taxes recorded by subsidiaries. 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 that would have been recognized in 2007 was offset by a valuation allowance.

Liquidity and Capital Resources*Parent Company*

We fund our operations with cash on hand as well as proceeds from sales of and distributions from partner companies, private equity funds and marketable securities. In prior periods, we have also used sales of our equity and issuance of debt as sources of liquidity. Our ability to generate liquidity from sales of partner companies, sales of

marketable

Table of Contents

securities and from equity and debt issuances has been adversely affected from time to time by declines in the US capital markets and other factors.

As of June 30, 2007, at the parent company level, we had \$71.9 million of cash and cash equivalents, \$0.2 million of restricted cash and \$53.8 million of marketable securities for a total of \$125.9 million. In addition to the amounts above, we have \$7.7 million in escrow associated with our interest payments due through March 2009 on the 2024 Debentures and our consolidated subsidiaries had cash and cash equivalents of \$4.9 million.

Proceeds from sales of and distributions from partner companies and funds were \$0 and \$2.3 million in the three and six months ended June 30, 2007 and \$0.2 million and \$1.7 million in the three and six months ended June 30, 2006, respectively.

We maintain a revolving credit facility that provides for borrowings and issuances of letters of credit and guarantees. In May 2007, we amended the facility to extend the maturity date to June 30, 2008 and to increase the size of the facility from \$55 million to \$75 million. In addition, our guarantee on a partner company facility was increased from \$5 million to \$7.5 million. Borrowing availability under the facility is reduced by the amounts outstanding for our borrowings and letters of credit and amounts guaranteed under partner company facilities maintained with that same lender. This credit facility bears interest at the prime rate (8.25% at June 30, 2007) for outstanding borrowings. The credit facility is subject to an unused commitment fee of 0.125%, which is subject to reduction based on deposits maintained at the bank. The facility requires cash collateral equal to one times our borrowings and letters of credit and amounts borrowed by partner companies under facilities maintained with that same bank.

In November 2006, we entered into an additional revolving credit facility with a separate bank that provides for borrowings and issuances of letters of credit and guarantees of up to \$20 million. Borrowing availability under the facility is reduced by the amounts outstanding for our borrowings and letters of credit and amounts guaranteed under partner company facilities maintained with that same lender. This credit facility bears interest at the prime rate for outstanding borrowings. The credit facility is subject to an unused commitment fee of 0.125%, which is subject to reduction based on deposits maintained at the bank. The facility requires cash collateral equal to one times our borrowings and letters of credit and amounts borrowed by partner companies under the guaranteed portion of the partner company facilities maintained at the same bank. The credit facility matures in November 2007.

Availability under our revolving credit facilities at June 30, 2007 was as follows (in thousands):

	Total
Size of facilities	\$ 95,000
Subsidiary facilities at same bank (a)	(40,800)
Outstanding letters of credit (b)	(6,336)
Amount available	\$ 47,864

(a) The amount available to borrow under the credit facilities is reduced by the amounts borrowed plus letters of credit and amounts guaranteed under partner company facilities maintained at the same respective banks. Of the total facilities, \$30.3 million was outstanding under these facilities at June 30, 2007 and was included as debt on the Consolidated Balance Sheet.

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

We have committed capital of approximately \$5.7 million comprising commitments made to various private equity funds in prior years and a conditional commitment to provide a partner company with additional funding, to be funded over the next several years, including approximately \$4.8 million which is expected to be funded in the next twelve months. We do not intend to commit to new investments in additional private equity funds and may seek to further reduce our current ownership interests in, and our existing commitments to the funds in which we hold interests.

The transactions we enter into in pursuit of our strategy could increase or decrease our liquidity at any point in time. As we seek to acquire interests in technology and life sciences companies or provide additional funding to existing partner companies, we may be required to expend our cash or incur debt, which will decrease our liquidity. Conversely, as we dispose

Table of Contents

of our interests in partner companies from time-to-time we may receive proceeds from such sales which could increase our liquidity. From time-to-time, we are engaged in discussions concerning acquisitions and dispositions which, if consummated, could impact our liquidity, perhaps significantly.

In May 2001, we entered into a \$26.5 million loan agreement with Warren V. Musser, our former Chairman and Chief Executive Officer. Through September 30, 2006, we recognized net impairment charges against the loan of \$15.4 million to the estimated value of the collateral that we in held at each respective date. Our efforts to collect Mr. Musser's outstanding loan obligation have included the sale of existing collateral, obtaining and selling additional collateral, litigation and negotiated resolution. Since 2001 and through September 30, 2006 we received a total of \$15.2 million in cash payments on the loan. In December 2006, we restructured the obligation to reduce the amount outstanding to \$14.8 million, bearing interest at the rate of 5% per annum, so that we could obtain new collateral, which is expected to be the primary source of repayment, along with additional collateral required to be provided to us over time. Subsequent to the restructuring of the obligation and prior to December 31, 2006, we received cash of approximately \$1.0 million from the sale of collateral. The carrying value of the loan at June 30, 2007 and December 31, 2006 was zero. Cash payments, when received, are recognized as Recovery-related party in our Consolidated Statements of Operations.

We have received distributions as both a general partner and a limited partner from certain private equity funds. Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner (the "clawback"). The clawback liability is joint and several, such that we may be required to fund the clawback for other general partners should they default. The funds have taken several steps to reduce the potential liabilities should other general partners default, including withholding all general partner distributions in escrow and adding rights of set-off among certain funds. We believe our liability due to the default of other general partners is remote. Assuming the private equity funds in which we are a general partner are liquidated or dissolved on June 30, 2007 and assuming for these purposes the only distributions from the funds were equal to the carrying value of the funds on the June 30, 2007 financial statements, the maximum clawback we would be required to return for our general partner interest is approximately \$8 million. As of June 30, 2007 management estimated this liability to be approximately \$6.7 million, of which \$5.3 million was reflected in accrued expenses and other current liabilities and \$1.4 million was reflected in other long-term liabilities on the Consolidated Balance Sheets.

We have outstanding \$129 million of 2.625% convertible senior debentures with a stated maturity of March 15, 2024. Interest on the 2024 Debentures is payable semi-annually. At the note holders' option, the notes are convertible into our common stock before the close of business on March 14, 2024 subject to certain conditions. The conversion rate of the notes at June 30, 2007 was \$7.2174 of principal amount per share. The closing price of our common stock on June 29, 2007 was \$2.81. The note holders may require repurchase of the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective amount plus accrued and unpaid interest. The note holders may also require repurchase of the 2024 Debentures upon certain events, including sale of all or substantially all of our common stock or assets, liquidation, dissolution or a change in control. Subject to certain conditions, we may redeem all or some of the 2024 Debentures commencing March 20, 2009. During 2006, we repurchased \$21 million of face value of the 2024 Debentures for \$16.4 million in cash.

For the reasons we have discussed, we believe our cash and cash equivalents at June 30, 2007 and other internal sources of cash flow are expected to be sufficient to fund our cash requirements for at least the next twelve months, including commitments to our existing companies and funds, our current operating plan to acquire interests in new partner companies and our general corporate requirements.

Consolidated Partner Companies

Most of our consolidated partner companies incurred losses in 2006 and the three and six months ended June 30, 2007 and may need additional capital to fund their operations. From time-to-time, some or all of our consolidated subsidiaries may require additional debt or equity financing or credit support from us to fund planned expansion activities. If we decide not to provide sufficient capital resources to allow them to reach a positive cash flow position, and they are unable to raise capital from outside resources, they may need to scale back their operations. If Alliance Consulting meets its business plan for the remainder of 2007 and the related milestones established by us, we believe it will have sufficient cash or availability under established lines of credit, as amended,

to fund its operations through 2007. We expect Acsis will require additional capital in 2007 to fund its business plan, and we believe that Laureate Pharma and Clariant may need additional capital in 2007. On March 7, 2007, we provided a subordinated revolving credit line (the Mezzanine Facility) to Clariant. Under the Mezzanine Facility, which expires December 8, 2008, we committed to provide Clariant access to up to \$6 million in working

Table of Contents

capital funding. Amounts funded under the Mezzanine Facility will earn interest at an annual rate of 12%. The Mezzanine Facility was originally \$12 million, but was reduced by \$6 million as a result of the ACIS Sale.

Alliance Consulting, Clariant and Laureate Pharma maintain credit facilities with our lender. Borrowings are secured by substantially all of the assets of the respective subsidiaries. These obligations bear interest at variable rates ranging between the prime rate minus 0.5% and the prime rate plus 0.5%. These facilities contain financial and non-financial covenants. During the three months ended June 30, 2007, Alliance Consulting and Clariant each did not comply with certain of their financial covenants under their respective facilities and subsequently received waivers from the lender.

As of June 30, 2007, outstanding borrowings by consolidated partner companies under guaranteed facilities were \$30.3 million.

In July 2007, Acsis amended and restated its credit facility with its bank, providing up to \$4.5 million of availability, subject to a borrowing base calculation. The facility expires in July 2008 and bears interest at rates ranging from the prime rate plus 1.5% to the prime rate plus 2.25% depending on Acsis liquidity. In addition, in July 2007, Acsis entered into a \$1.5 million loan facility with the same bank which expires on September 15, 2007 and bears interest at the prime rate. We have guaranteed the \$1.5 million facility.

In September 2006, Clariant entered into a \$5 million senior secured revolving credit agreement. Borrowing availability under the agreement is based on the level of Clariant's qualified accounts receivable, less certain reserves. The agreement has a two-year term and bears interest at variable rates based on the lower of LIBOR plus 3.25% or the prime rate plus 0.5%. As of June 30, 2007, Clariant had \$1.3 million outstanding borrowings under this facility and had \$2.2 million availability based on the level of qualified accounts receivable. During the three months ended June 30, 2007 Clariant did not comply with certain of its financial covenants under this facility and subsequently received a waiver from the lender.

Analysis of Parent Company Cash Flows

Cash flow activity for the Parent Company was as follows:

	Six Months Ended June 30,	
	2007	2006
	(in thousands)	
Net cash used in operating activities	\$ (9,350)	\$ (5,710)
Net cash provided by (used in) investing activities	20,806	(19,905)
Net cash provided by (used in) financing activities	539	(3,919)
	\$ 11,995	\$ (29,534)

Cash Used In Operating Activities

Net cash used in operating activities increased \$3.6 million in 2007 as compared to the prior year period. The increase was primarily attributable to the increased net loss in 2007 as compared to 2006.

Cash Provided by (Used In) Investing Activities

Cash provided by (used in) investing activities primarily reflects the acquisition of ownership interests in companies from third parties, partially offset by proceeds from the sales of non-strategic assets and private equity funds.

Net cash provided by investing activities increased \$40.7 million in 2007 as compared to the prior year period. This increase was primarily attributable to a \$47.5 million net decrease in marketable securities and a \$19.7 million net increase from the proceeds from discontinued operations in 2007 as compared to the prior year period. Partially offsetting the overall increase was a \$27.3 million net increase in cash used for acquisitions of ownership interests in companies and funds, net of cash acquired.

Cash Provided by (Used In) Financing Activities

Net cash provided by (used in) financing activities increased \$4.5 million in 2007 as compared to the prior year period. The increase was primarily related to \$3.8 million of cash used to repurchase \$5.0 million of face value of the 2024 Debentures in the first quarter of 2006 and advances to subsidiaries of \$0.5 million in 2006.

Table of Contents**Consolidated Working Capital**

Consolidated working capital decreased to \$95.8 million at June 30, 2007 compared to \$128.8 million at December 31, 2006. The decrease is primarily attributable to cash expended on new and follow-on holdings as well as to fund continuing operations.

Analysis of Consolidated Company Cash Flows

Cash flow activity was as follows:

	Six Months Ended June 30,	
	2007	2006
	(in thousands)	
Net cash used in operating activities	\$ (24,163)	\$ (15,009)
Net cash provided by (used in) investing activities	23,459	(18,267)
Net cash provided by financing activities	11,846	249
	\$ 11,142	\$ (33,027)

Cash Used in Operating Activities

Net cash used in operating activities increased \$9.2 million in 2007 as compared to the prior year period. The increase was primarily related to an increase in net loss, offset by working capital changes in 2007 as compared to the prior year period.

Cash Provided by (Used In) Investing Activities

Net cash provided by (used in) investing activities increased \$41.7 million in 2007 as compared to the prior year period. This increase was primarily related to a net increase of \$23.8 million of proceeds from the sale of discontinued operations and a net decrease of \$47.5 million in marketable securities. Partially offsetting the overall increase was a net increase of \$35.0 million net increase in cash used for acquisitions of ownership interests in companies and funds, net of cash acquired in 2007 as compared to the prior year period.

Cash Provided by Financing Activities

Net cash provided by financing activities increased \$11.6 million in 2007 as compared to the prior year period. The increase was primarily related to an increase in net borrowings under credit facilities and term debt in 2007 and a decrease of \$3.8 million of cash used to repurchase \$5.0 million of face value of the 2024 Debentures in the first quarter of 2006.

Contractual Cash Obligations and Other Commercial Commitments

The following table summarizes our contractual obligations and other commercial commitments as of June 30, 2007 by period due or expiration of the commitment.

	Total	Payments Due by Period			Due after 2011
		Rest of 2007	2008 and 2009	2010 and 2011	
			(in millions)		
Contractual Cash Obligations					
Lines of credit (a)	\$ 35.2	\$ --	\$ 35.2	\$ --	\$ --
Long-term debt (a)	5.3	0.9	3.5	0.9	--
Capital leases	3.1	1.1	2.0	--	--
Convertible senior debentures (b)	129.0	--	--	--	129.0
Operating leases	28.6	2.8	8.4	5.5	11.9
Funding commitments (c)	5.8	4.2	1.5	0.1	--
Potential clawback liabilities (d)	6.7	5.3	--	--	1.4
Other long-term obligations (e)	3.0	0.3	1.2	1.4	0.1

Edgar Filing: SAFEGUARD SCIENTIFICS INC - Form 10-Q

Total Contractual Cash Obligations	\$216.7	\$ 14.6	\$ 51.8	\$ 7.9	\$ 142.4
------------------------------------	---------	---------	---------	--------	----------

40

Table of Contents**Amount of Commitment Expiration by Period**

	Total	Rest of 2007	2008 and 2009 (in millions)	2010 and 2011	Due after 2011
Other Commitments					
Letters of credit (f)	\$ 9.4	\$ 0.1	\$ 3.0	\$ --	\$ 6.3

- (a) We have various forms of debt including lines of credit, term loans and equipment leases. Of our total outstanding guarantees of \$49.3 million, \$30.3 million of outstanding debt associated with the guarantees was included on the Consolidated Balance Sheet at June 30, 2007. The remaining \$19.0 million was not reflected on the Consolidated Balance Sheet or in the above table.
- (b) In February 2004, we completed the issuance of \$150 million of the 2024 Debentures with a stated maturity of March 15, 2024. During 2006, we repurchased \$21 million of the face value of the 2024 Debentures for \$16.4 million in cash. The 2024 Debenture holders may require us to repurchase the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount plus accrued and unpaid interest.
- (c) These amounts include funding commitments to private equity funds and private companies. The amounts have been included in the respective years based on estimated timing of capital calls provided to us by the funds management. Also included is our \$3.0 million conditional commitment to provide a partner company with additional funding.
- (d) We have received distributions as both a general partner and a limited partner from certain private equity funds. Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner to the fund for a further distribution to the fund's limited partners (the clawback). Assuming the funds were liquidated or dissolved on June 30, 2007 and the only value provided by the funds was the carrying values represented on the June 30, 2007 financial statements, the maximum clawback we would be required to return is \$8 million. As of June 30, 2007, management estimated its liability to be approximately \$6.7 million, of which \$5.3 million was reflected in accrued expenses and other current liabilities and \$1.4 million was reflected in other long-term liabilities on the Consolidated Balance Sheets.
- (e) Reflects the amount payable to our former Chairman and CEO under a consulting contract.
- (f) Letters of credit include a \$6.3 million letter of credit provided to the landlord of CompuCom's Dallas headquarters lease in connection with the sale of CompuCom and \$3.1 million of letters of credit issued by or on behalf of partner companies supporting their office leases.

We have retention employment agreements with certain executive officers that provide for severance payments to the executive officer in the event the officer is terminated without cause or the officer terminates their employment for good reason.

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

Recent Accounting Pronouncements

See Note 6 to the Consolidated Financial Statements.

Table of Contents

Factors That May Affect Future Results

You should carefully consider the information set forth below before making an investment decision. If any of the following risks actually occur, our business, financial condition or results of operations could be materially harmed, and the value of our securities may decline. You should also refer to other information included or incorporated by reference in this report.

Risks Related to Our Business

Our business depends upon the performance of our partner companies, which is uncertain.

If our partner companies do not succeed, the value of our assets could be significantly reduced and require substantial impairments or write-offs, and our results of operations and the price of our common stock could decline. The risks relating to our partner companies include:

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

These risks are discussed in greater detail under the caption **Risks Related to Our Partner Companies** below. *The identity of our partner companies and the nature of our interests in them could vary widely from period to period.*

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

- § change the partner companies on which we focus;
- § sell some or all of our interests in any of our partner companies;
- § or otherwise change the nature of our interests in our partner companies. Therefore, the nature of our holdings could vary significantly from period to period.

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

- § For the three and six months ended June 30, 2007, we consolidated the results of operations of Acsis, Alliance Consulting, Clariant and Laureate Pharma.

§ In March 2007, we completed the sale of Pacific Title and Art Studio and its results of operations for the periods

Table of Contents

prior to the sale are presented as discontinued operations in the consolidated financial statements.

Our partner companies currently provide us with little cash flow from their operations so 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 acquire new partner companies and to fund the capital needs of our existing partner companies. We also need cash to service and repay our outstanding debt, finance our corporate overhead and meet our funding commitments to private equity funds. As a result, we have substantial cash requirements. Our partner companies currently provide us with little cash flow from their operations. To the extent our partner companies generate any cash from operations, they generally retain the funds to develop their own businesses. As a result, we must rely on cash on hand, liquidity events and new capital raising activities to meet our cash needs. If we are unable to find ways of monetizing our holdings or to raise additional capital on attractive terms, we may face liquidity issues that will require us to curtail our new business efforts, constrain our ability to execute our business strategy and limit our ability to provide financial support to our existing partner companies.

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

Fluctuations in the market prices of the common stock of our publicly-traded holdings are likely to affect the price of our common stock. The market prices of our publicly-traded holdings have been highly volatile and subject to fluctuations unrelated or disproportionate to operating performance. For example, the aggregate market value of our holdings in Clariant (Nasdaq: CLRT) at June 30, 2007 was approximately \$85.9 million and at December 31, 2006 was approximately \$72.8 million.

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

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

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

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

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

Our success is dependent on our executive management.

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

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

Our strategy involves creating value for our shareholders by helping our partner companies build value and, if appropriate, accessing the public and private capital markets. Therefore, our success is dependent on the value of our partner

Table of Contents

companies as determined by the public and private capital markets. Many factors, including reduced market interest, may cause the market value of our publicly traded partner companies to decline. If valuations in the market sectors in which our partner companies participate decline, their access to the public and private capital markets on terms acceptable to them may be limited.

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

Although we may seek a controlling equity interest and participation in the management of our partner companies, we may not be able to control the significant business decisions of our partner companies. We may have shared control or no control over some of our partner companies. In addition, although we currently own a controlling interest in some of our partner companies, we may not maintain this controlling interest. Acquisitions of interests in partner companies in which we share or have no control, and the dilution of our interests in or loss of control of partner companies, will involve additional risks that could cause the performance of our interests and our operating results to suffer, including:

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

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

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

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

The Investment Company Act of 1940 regulates companies which are engaged primarily in the business of investing, reinvesting, owning, holding or trading in securities. Under the Investment Company Act, a company may be deemed to be an investment company if it owns investment securities with a value exceeding 40% of the value of its total assets (excluding government securities and cash items) on an unconsolidated basis, unless an exemption or safe harbor applies. We refer to this test as the 40% Test. Securities issued by companies other than majority-owned subsidiaries are generally considered investment securities for purpose of the Investment Company Act. We are a company that partners with growth-stage technology and life sciences companies to build value; we are not engaged primarily in the business of investing, reinvesting or trading in securities. We are in compliance with the 40% Test. Consequently, we do not believe that we are an investment company under the Investment Company Act.

We monitor our compliance with the 40% Test and seek to conduct our business activities to comply with this test. It is not feasible for us to be regulated as an investment company because the Investment Company Act rules are inconsistent with our strategy of actively helping our partner companies in their efforts to build value. In order to continue to comply with the 40% Test, we may need to take various actions which we would otherwise not pursue. For example, we may need to retain a majority interest in a partner company that we no longer consider strategic, we may not be able to acquire an interest in a company unless we are able to obtain majority ownership interest in the company, or we may be limited in the manner or timing in which we sell our interests in a partner company. Our ownership levels may also be affected if our partner companies are acquired by third parties or if our partner companies issue stock which dilutes our majority ownership. The actions we may need to take to address these issues while maintaining compliance with the 40% Test could adversely affect our ability to create and realize value at our partner companies.

Risks Related to Our Partner Companies

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

Most of our partner companies have a history of operating losses or limited operating history, have significant historical losses and may never be profitable. Many have incurred substantial costs to develop and market their

products, have incurred net losses and cannot fund their cash needs from operations. We expect that the operating expenses of certain of our

Table of Contents

partner companies will increase substantially in the foreseeable future as they continue to develop products and services, increase sales and marketing efforts and expand operations.

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

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

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

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

The technology and life sciences marketplaces are characterized by:

- § rapidly changing technology;
- § evolving industry standards;
- § frequent new products and services;
- § 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 this rapidly evolving marketplace. They may not be able to adequately or economically adapt their products and services, develop new products and services or establish and maintain effective distribution channels for their products and services. If our partner companies are unable to offer competitive products and services or maintain effective distribution channels, they will sell fewer products and services and forego potential revenue, possibly causing them to lose money. In addition, we and our partner companies may not be able to respond to the rapid technology changes in an economically efficient manner, and our partner companies may become or remain unprofitable.

Many of our partner companies may grow rapidly and may be unable to manage their growth.

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

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

§ attract and maintain qualified personnel; and

§ maintain appropriate levels of liquidity.

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

Table of Contents

Our partner companies may need to raise 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.

Our partner companies may need to raise additional funds in the future and we cannot be certain that they will be able to obtain additional financing on favorable terms, if at all. Because our resources and our ability to raise capital are limited, we may not be able to provide our partner companies with sufficient capital resources to enable them to reach a cash flow positive position. If our partner companies need to, but are not able to raise capital from other outside sources, then they may need to cease or scale back operations.

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

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

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

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

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

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

Table of Contents

Our partner companies are dependent upon their ability to attract and retain senior management and key personnel, including trained technical and marketing personnel. Our partner companies will also need to continue to hire additional personnel as they expand. A shortage in the availability of the requisite qualified personnel would limit the ability of our partner companies to grow, to increase sales of their existing products and services and to launch new products and services.

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

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

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

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

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

We are exposed to equity price risks on the marketable portion of our securities. These securities include an equity position in one public partner company, Clariant, which has experienced significant volatility in its stock price. Historically, we have not attempted to reduce or eliminate our market exposure on securities. Based on closing market prices at June 30, 2007, the fair market value of our holdings in public securities was approximately \$85.9 million. A 20% decrease in equity prices would result in an approximate \$17.2 million decrease in the fair value of our publicly traded securities.

In February 2004, we completed the issuance of \$150 million of fixed rate notes with a stated maturity of March 2024. Interest payments of approximately \$1.7 million are due March and September of each year. The holders of the 2024 Debentures may require repurchase of the notes on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective amount plus accrued and unpaid interest. On October 8, 2004, we utilized approximately \$16.7 million of the proceeds from the CompuCom sale to escrow interest payments due through March 15, 2009. During 2006, the Company repurchased \$21.0 million of the face value of the 2024 Debentures for \$16.4 million in cash.

Liabilities	Remainder				Fair Market
	of 2007	2008	2009	After 2009	Value at June 30, 2007
Convertible Senior Notes due by year (in millions)	--	--	--	\$ 129.0	\$ 110.9
Fixed Interest Rate	2.625%	2.625%	2.625%	2.625%	N/A
Interest Expense (in millions)	\$1.7	\$3.4	\$3.4	\$48.1	N/A

Item 4. *Controls and Procedures*

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report 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,

Table of Contents

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, however, 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.

No change in our internal control over financial reporting occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Our business strategy involves the acquisition of new businesses on an on-going basis, most of which are young, growing companies. Typically, these companies have not historically had all of the controls and procedures they would need to comply with the requirements of the Securities Exchange Act of 1934 and the rules promulgated thereunder. These companies also frequently develop new products and services. Following an acquisition, or the launch of a new product or service, we work with the company's management to implement all necessary controls and procedures.

Table of Contents

PART II
OTHER INFORMATION

Item 1A. Risk Factors

Except as set forth below, there have been no material changes in our risk factors from the information set forth above under the heading "Factors That May Affect Future Results" and in our Annual Report on Form 10-K for the year ended December 31, 2006.

The identity of our partner companies and the nature of our interests in them could vary widely from period to period.

As part of our strategy, we continually assess the value to our shareholders of our interests in our partner companies. We also regularly evaluate alternative uses for our capital resources. As a result, depending on market conditions, growth prospects and other key factors, we may, at any time, change the partner companies on which we focus, sell some or all of our interests in any of our partner companies or otherwise change the nature of our interests in our partner companies. Therefore, the nature of our holdings in them could vary significantly from period to period.

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

§ For the three and six months ended June 30, 2007, we consolidated the results of operations of Acsis, Alliance Consulting, Clariant and Laureate Pharma.

§ In March 2007, we completed the sale of Pacific Title and Art Studio and its results of operations for the periods prior to the sale are presented as discontinued operations in the consolidated financial statements.

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

Fluctuations in the market prices of the common stock of our publicly-traded holdings are likely to affect the price of our common stock. The market prices of our publicly-traded holdings have been highly volatile and subject to fluctuations unrelated or disproportionate to operating performance. For example, the aggregate market value of our holdings in Clariant (Nasdaq: CLRT) at June 30, 2007 was approximately \$85.9 million, and at December 31, 2006 was approximately \$72.8 million.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect our business, financial condition or future results. The risks described in this report and in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
June 15, 2007	21,900	\$2.68	N/A	N/A
June 15, 2007	2,400	\$2.67	N/A	N/A
June 15, 2007	1,600	\$2.66	N/A	N/A
June 15, 2007	200	\$2.65	N/A	N/A

The purchases reported in the above table were open market purchases made by an individual who may be considered an affiliated purchaser of the Registrant under Rule 10b-18 of the Securities Exchange Act of 1934, as amended.

Table of Contents**Item 4. Submission of Matters to a Vote of Security Holders.**

The shareholders of the Company voted on two items of business at the Annual Meeting of Shareholders held on May 24, 2007:

1. The election of ten directors and
2. A proposal to ratify the appointment of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007.

The nominees for director were elected based upon the following votes:

NOMINEE	VOTES FOR	VOTES WITHHELD
Peter J. Boni	107,308,640	2,280,783
Michael J. Cody	107,353,678	2,235,678
Julie A. Dobson	105,512,166	4,077,257
Robert E. Keith, Jr.	107,170,659	2,418,764
Andrew E. Lietz	105,492,493	4,096,930
George MacKenzie	107,378,135	2,211,288
George D. McClelland	107,394,420	2,195,003
Jack L. Messman	107,216,828	2,372,595
John W. Poduska, Sr.	107,462,310	2,127,113
John J. Roberts	105,561,288	4,028,135

The proposal to ratify the appointment of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2007 received the following votes:

108,073,871	VOTES FOR
1,033,315	VOTES AGAINST
482,238	ABSTENTIONS
0	BROKER NON-VOTE

Table of Contents**Item 6. Exhibits**

(a) Exhibits.

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

Exhibit Number	Description	Incorporated Filing Reference	
		Form Type & Filing Date	Original Exhibit Number
10.1.1	Ninth Amendment dated May 2, 2007 to Loan Agreement dated as of May 10, 2002, as amended, by and between Comerica Bank, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 10-Q 5/10/07	10.2.2
10.1.2	Amendment and Affirmation of Guaranty dated May 2, 2007 by Safeguard Scientifics, Inc.	Form 10-Q 5/10/07	10.2.3
10.2.1	First Amendment and Waiver dated May 2, 2007 to Amended and Restated Loan Agreement dated February 28, 2007 by and among Comerica Bank, Alliance Consulting Group Associates, Inc. and Alliance Holdings, Inc. (\$12.5 million credit facility)	Form 10-Q 5/10/07	10.3.4
10.2.2	First Amendment and Waiver dated May 2, 2007 to Amended and Restated Loan Agreement dated February 28, 2007 by and among Comerica Bank, Alliance Consulting Group Associates, Inc. and Alliance Holdings, Inc. (\$7.5 million credit facility)	Form 10-Q 5/10/07	10.3.5
10.2.3	Affirmation of Guaranty dated May 2, 2007 by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Alliance)	Form 10-Q 5/10/07	10.3.6
10.3 *	2007 Management Incentive Plan	Form 8-K 4/26/07	99.1
10.4.1 *	Agreement by and between Safeguard Scientifics, Inc. and Raymond J. Land dated May 24, 2007	Form 8-K 6/11/07	99.1
10.4.2 *	Stock Option Grant Certificate issued to Raymond J. Land dated June 11, 2007		
31.1	Certification of Peter J. Boni pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934		
31.2	Certification of Raymond J. Land pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934		
32.1	Certification of Peter J. Boni pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the		

Sarbanes-Oxley Act of
2002.

32.2

Certification of Raymond J. Land pursuant to 18 U.S.C.
Section 1350, as Adopted pursuant to Section 906 of the
Sarbanes-Oxley
Act of 2002.

Filed herewith

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

Table of Contents

SIGNATURES

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

SAFEGUARD SCIENTIFICS, INC.

Date: August 3, 2007

PETER J. BONI

Peter J. Boni
President and Chief Executive Officer

Date: August 3, 2007

RAYMOND J. LAND

Raymond J. Land
Senior Vice President and Chief Financial Officer

52