QUADRAMED CORP
Form 10-Q
August 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

OR

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

FOR THE TRANSITION PERIOD FROM ___________ TO ___________

COMMISSION FILE NUMBER: 0-21031

QUADRAMED CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	52-1992861 (I.R.S. EMPLOYER IDENTIFICATION NO.)
22 PELICAN WAY SAN RAFAEL, CA 94901 (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	94901 (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (415) 482-2100

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 [X] No [ ]

As of August 2, 2001 there were 25,898,876 shares of the Registrant's Common Stock outstanding, par value $0.01. This quarterly report on Form 10-Q consists of 30 pages of which this is page 1. The Exhibit Index is located at page 1.

QUADRAMED CORPORATION

TABLE OF CONTENTS

PAGE NUMBER

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

Condensed Consolidated Balance Sheets as of June 30, 2001 and December 31, 2000....3
Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2001 and 2000....4
Condensed Consolidated Statements of Cash Flows for the three and six months ended June 30, 2001 and 2000....5
Notes to Condensed Consolidated Financial Statements....6

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations....16

Item 3. Quantitative and Qualitative Disclosures About Market Risk....19

PART II. OTHER INFORMATION

Item 1. Legal Proceedings....28
Item 2. Changes in Securities and Use of Proceeds....28
Item 3. Defaults Upon Senior Securities....28
Item 4. Submission of Matters to a Vote of Security Holders....28
Item 5. Other Information....29
Item 6. Exhibits and Reports on Form 8-K....29

QUADRAMED CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

ASSETS	June 3 2001 (unaudi
Current Assets:	
Cash and cash equivalents	$ 42
Restricted cash	4
Short-term investments	2
Accounts receivable, net of allowance for uncollectible accounts of $4,100 and $2,404, respectively	37
Unbilled receivables	7
Notes and other receivables	
Prepaid expenses and other current assets	2
Total current	98
Long-term investments	1
Long-term notes receivable	3
Equipment, at cost:	
Equipment	29
Less accumulated depreciation and amortization	(21,

Equipment, net	7
Capitalized software development, net of accumulated amortization of $6,972 and $5,517, respectively	8
Acquired software, net of accumulated amortization of $3,891 and $3,441, respectively	
Intangibles, net of accumulated amortization of $20,336 and $17,443, respectively	25
Marketable investments	
Other long term assets	5
Total Assets	$ 152

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Current maturities of capital lease obligations	$
Accounts payable	
Accrued payroll and related	8
Accrued interest	
Other accrued liabilities	
Deferred revenue	2
Total current liabilities	39
Capital lease obligations, less current portion	
Convertible subordinated debentures	109
Net liabilities of discontinued operations	
Total Liabilities	149
Stockholders' Equity:	
Common stock, $0.01 par, 50,000 shares authorized, 25,566,488 and 25,756,861 shares issued and outstanding, respectively	
Additional paid-in-capital	268
Accumulated other comprehensive loss	(4,
Accumulated deficit	(261,
Total stockholders' equity	2
Total Liabilities and Stockholders' Equity	$ 152

The accompanying notes are an integral part of these condensed consolidated financial statements.

QUADRAMED CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited

	Three Months Ended June 30,	
	2001	2000
		Restated
Revenues:		
Licenses	$ 23,016	$ 22,
Services	10,636	13,
Total Revenues	33,652	36,
Operating Expenses:		
Cost of licenses	6,173	5,
Cost of services	4,924	10,
General and administration	12,862	10,
Sales and marketing	4,024	6,
Research and development	3,804	5,
Amortization of intangibles	1,672	1,
Impairment of intangible assets	-	
Non-recurring charges	-	16,
Total operating expenses	33,459	56,
Income (Loss) from Operations	193	(20,5
Other Income (Expense):		
Interest expense	(1,626)	(1,6
Interest income	1,154	
Other income (expense), net	(111)	(
Total other expense, net	(583)	(1,1
Loss Before Income Taxes	(390)	(21,6
Provision for income taxes	(23)	(4
Loss from Continuing Operations	(413)	(22,0
Gain on redemption of bonds (net of applicable tax)	2,401	
Income from discontinued operations (net of applicable tax)	-	
(Loss) gain on sale of division (net of applicable tax)	(327)	
Net Income (Loss) Available to Common Stockholders	$ 1,661	$ (4,0
Earnings Per Common Share:		
Basic and Diluted Loss per Share from Continuing Operations	$ (0.02)	$ (0.
Basic and Diluted Net Income per Share from Discontinued Operations (net of applicable tax)	$ -	$ 0
Basic and Diluted (Loss) Gain on Sale of Division (net of	$ (0.01)	$ 0

Basic and Diluted Gain on Redemption of Bonds (net of applicable tax)	$	0.09	$	
Basic and Diluted Net Income (Loss) per Share Available to Common Stockholders	$	0.06	$	(0.
Weighted Average Shares Outstanding:				
Diluted		25,756		25,
Basic		25,756		25,

(1) Prior year financial statements have been restated to be consistent with current year reclassification of cost of licenses, cost of services, and operating expenses for general and administration, sales and marketing, and research and development.

The accompanying notes are an integral part of these condensed consolidated financial statements

QUADRAMED CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

		200
Cash Flows from Operating Activities:		
Net loss	$	(
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation and amortization		
Write-off of long term investments		
Write-off of acquired software		
Write-off of notes payable		
Write-off of capitalized software		
Impairment of intangible assets		
Cash flows from discontinued operations		(
Loss (gain) on the sale of division, net of applicable tax		
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable and unbilled receivables, net		
Prepaid expenses and other		
Accounts payable and accrued liabilities		
Deferred revenue		
Cash provided by (used in) operating activities		

Cash Flows from Investing Activities:	
Maturity (purchase) of available-for-sale securities, net	
Additions to equipment	(
Proceeds from the sale of division	
Investment in ChartOne	
Disposal of equipment	
Change in restricted cash	
Capitalization of computer software development costs	
Cash provided by investing activities	
Cash Flows from Financing Activities:	
Payments of principal on capital lease obligations	
Repayments of notes and loans payable	(
Issuance of common stock through Employee Stock Purchase Plan	
Proceeds from exercise of common stock options to purchase common stock	
Cash (used in) provided by financing activities	(
Net increase in cash and cash equivalents	
Cash and Cash Equivalents, beginning of period	
Cash and Cash Equivalents, end of period	$
Supplemental Disclosure of Cash Flow Information:	
Cash paid for interest	$
Cash paid for taxes	
Supplemental Disclosure of Noncash Investing and Financing Transactions:	
Cancellation of restricted common stock	$
Issuance of common stock in payment of legal expenses	
Release of restricted cash into short term investments	

(1) Certain amounts in the prior year financial statements have been reclassed to be con
presentation.

The accompanying notes are an integral part of these condensed consolidated financial statements.

QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2001

1. QUADRAMED CORPORATION

QuadraMed Corporation is a healthcare information technology leader with software, web-enabled solutions, and professional consulting services that enable hospitals and providers to efficiently and effectively manage their delivery of healthcare. QuadraMed provides products and services facilitating all facets of healthcare information management, including clinical, patient, financial, compliance, and managed care. QuadraMed serves more than half of the U.S. hospitals and supports global healthcare initiatives with a dedicated staff of over 1000 professionals.

QuadraMed was incorporated in California in 1993 and reincorporated in Delaware in 1996. Its stock is publicly traded under the symbol "QMDC" on the Nasdaq SmallCap Market. From October 16, 1996, to August 30, 2000, QuadraMed's stock was traded on the Nasdaq National Market.

2. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

(a) Basis of Presentation and Principles of Consolidation

These condensed consolidated financial statements include the accounts of QuadraMed Corporation and all significant business divisions and subsidiaries (hereinafter "QuadraMed") and have been prepared in conformity with (i) generally accepted accounting principles in the United States of America; and (ii) the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). All significant intercompany accounts and transactions between QuadraMed and its subsidiaries are eliminated in consolidation.

These financial statements reflect all adjustments that are, in management's opinion, necessary for a fair presentation of our results of operations and financial condition.
All adjustments that have been included in these financial statements are of a normal recurring nature.

Results of QuadraMed's Release Of Information ("ROI") Division are reported as discontinued operations because control of that business was transferred in May of 2000. Unless otherwise indicated, amounts in these statements exclude the effects of all discontinued operations.

(b) Reclassifications

Certain reclassifications have been made to the 2000 consolidated financial statements to conform to the 2001 presentation. Specifically, June 30, 2000, financial statements have been restated to be consistent with the current classification of cost of licenses, cost of services, general and administration, sales and marketing, research and development, marketable investments and discontinued operations.

(c) Use of Estimates in Preparation of Financial Statements

In preparing these financial statements in conformity with

generally accepted accounting principles, QuadraMed's management has made estimates and assumptions that affect the reported amounts of assets and liabilities, disclosed contingent assets and liabilities, and reported revenues and expenses. Actual results could differ from these estimates. Significant estimates and assumptions have been made regarding intangible assets, primarily goodwill, resulting from QuadraMed's acquisitions.

(d) Cash and Cash Equivalents

QuadraMed treats all certificates of deposit, money market accounts, and commercial paper with maturities of three months or less, as cash equivalents.

(e) Restricted Cash

As collateral for stand-by letters of credit, QuadraMed had restricted cash balances of $4.3 million and $9.0 million at June 30, 2001, and 2000, respectively. These balances are secured with certificates of deposit.

In June 2001, $2.4 million of restricted cash was released and then invested in short-term investments.

(f) Investments

QuadraMed considers its short- and long-term securities, consisting primarily of debt securities, to be available-for-sale securities. The difference between cost and amortized cost (cost adjusted for amortization of premiums and accretion of discounts that are recognized as adjustments to interest income) and fair value (representing unrealized holdings gains or losses) are recorded, until realized, as a separate component of stockholders' equity. Gains and losses on the sale of debt securities are determined on a specific identification basis. Realized gains and losses are included in other income (expense) in the accompanying consolidated statement of operations.

During the quarter ended June 30, 2001, $12.2 million in short-term investments matured and are reflected as cash and cash equivalents on the current balance sheet.

(g) Equipment

Equipment is stated at cost and depreciated using the straight-line method over its estimated useful life, which is generally from three to five years. Depreciation expense was $1.7 million and $2.2 million for the six-month periods ending June 30, 2001, and 2000, respectively. Leasehold improvements are amortized over the term of the lease. Maintenance and repairs are expensed as incurred.

(h) Intangibles

Intangibles include goodwill, which is the amount of purchase price in excess of the fair value of the tangible net assets, and other identifiable intangible assets acquired through QuadraMed's acquisitions. Capitalized amounts are amortized on a straight-line basis over a period of five to ten years. Goodwill is evaluated quarterly for impairment and written down to net realizable value if necessary.

(i) Revenue Recognition

QuadraMed's revenues are derived from two sources: (1) software products; and (2) consulting services. Software product revenues include

amounts received for licenses and software-related services, such as installation and post-installation customer support fees, third-party hardware sales, and other software-related revenue. Consulting services revenues include amounts from QuadraMed's Health Information Management Services Division and Financial Services Division.

QuadraMed's software products (enterprise-wide systems and specific applications) can be licensed individually or as a suite of interrelated products. Licenses are granted for a specified term (generally ranging from one to five years; typically paid monthly or annually) or in perpetuity. Revenues from enterprise-wide systems are recognized on the basis of percentage of completion. Term licenses for specific applications are recognized monthly or annually over the term of the license arrangement, beginning at the date of installation. Revenues from perpetual licenses for specific applications are recognized upon shipment of the software if there is persuasive evidence of an agreement, collection of the resulting receivable is probable, and the fee is fixed and determinable. If there is a contractual acceptance period, revenues are recognized on the earlier: of (i) acceptance; or (ii) the expiration of the acceptance period. Software-related service revenue is recognized upon completion of installation. Unbilled receivables consist of work performed or software delivered which has not been billed pursuant to the customer contract. Post-installation customer support is recognized ratably over the term of the support period. Deferred revenue is revenue received in advance from customers for future work. Costs of software products include hardware, royalties to third parties, and installation costs. QuadraMed's consulting services are rendered under contracts with providers calling for fixed monthly payments and revenue is recognized at the end of each month as services are provided. Cash flow management contracts generally provide for incentive payments based on a percentage of dollars recovered for the provider. QuadraMed recognizes this additional incentive revenue upon receipt of payment from the provider. Cost of service revenues consists primarily of salaries, benefits and allocated costs related to providing such services.

(j) Income Taxes

QuadraMed accounts for income taxes pursuant to Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," ("SFAS No. 109"). SFAS No. 109 provides for an asset and liability approach to accounting for income taxes under which deferred income taxes are provided based upon enacted tax laws and rates applicable to the periods in which taxes become payable.

(k) Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the sum of weighted average number of common shares and common equivalent shares outstanding during the period. Common equivalent shares consist of shares issuable upon the exercise of stock options (using the treasury stock method) and convertible subordinated debentures (using the if converted method). Common equivalent shares are excluded from the diluted computation only if their effect is anti-dilutive. As the Company recorded a net loss from continuing operations for the six months and three months ended June 30, 2001, and 2000 no common equivalent shares are included in the diluted weighted average common shares for those periods.

(l) Comprehensive Income

In 1997, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income," which was adopted by the Company in the first quarter of 1998. SFAS No. 130 requires companies to report a new, additional measure of income on the income statement or to create a new financial statement that has the new measure of income on it.

The components of comprehensive income (loss) for the six months ended June 30, 2001, and 2000 are as follows (in thousands):

	June 30, 2001	June 30, 2000
Net income (loss)	$1,661	$ (4,084)
Unrealized gain (loss) on available-for-sale securities	(22)	(1,445)
Comprehensive income (loss)	$1,639	$ (5,529)

(m) Software Development Costs

Software development costs are capitalized, upon the establishment of technological feasibility. QuadraMed establishes technological feasibility upon completion of a detail program design, in accordance with FAS-86. The detail program design substantiates that the computer software product can be produced in accordance with its design specifications. Capitalized software development costs require a continuing assessment of their recoverability. This assessment requires considerable judgment by us with respect to various factors, including, but not limited to, anticipated future gross product revenues, estimated economic lives and changes in software and hardware technology. For the six months ended June 30, 2001, and 2000, the Company capitalized software development costs of $0.5 million, and $0.9 million, respectively. During the six-month period ending June 30, 2000, QuadraMed recorded a $1.1 million charge to write-down certain capitalized software assets related to the acquisition of IMN. There were no write-downs of capitalized software assets for the six-month period ending June 30, 2001.

Amortization of capitalized software development costs was $1.5 million and $1.1 million for the six months ended June 30, 2001, and 2000, respectively. Amortization is based upon the greater of the amount computed using (a) the ratio of current gross revenues for a product to the total of current and anticipated future gross revenues for that product or (b) the straight-line method over the remaining estimated economic life of the product, generally five years.

3. STOCKHOLDERS' EQUITY

In May 2001, the Company's stockholders approved an increase in the maximum number of shares issuable under the Company's 1996 Stock Incentive Plan from 3,953,981 to an aggregate total of 5,118,981.

4. SUBORDINATED CONVERTIBLE DEBENTURES

In April 1998, QuadraMed completed an offering of $115 million principal amount of Convertible Subordinated Debentures (the "Debentures"), including the underwriters' over-allotment option. The Debentures are due May 1, 2005, and bear interest at 5.25% per annum. The Debentures are convertible into common stock at any time prior to the redemption or final maturity, initially at the conversion price of $33.25 per share (resulting in an initial conversion ratio of 30.075 shares per $1,000 principal amount). Net proceeds to QuadraMed from the offering were $110.8 million.

In May 2001, QuadraMed redeemed $5.4 million face value of convertible subordinated debentures at prices ranging from $53.00 to $53.75. The Company recognized an extraordinary gain of $2.4 million after applicable taxes as a result of the early extinguishment of debt.

5. DISCONTINUED OPERATIONS

In connection with the acquisition of Compucare in March 1999, QuadraMed assumed the net liabilities of discontinued operations from previous Compucare acquisitions. Included in this net liability are balances related to Compucare's sale of two wholly owned subsidiaries. The two sales were as follows: (1) Antrim Corporation in November, 1996; and (2) Health Systems Integration, Inc. ("HSII").

During the quarter ended June 30, 2001, QuadraMed consummated the sale of its discontinued Electronic Remittance Advice product line. QuadraMed recorded proceeds from the sale of $24 thousand and a loss after applicable taxes of $327 thousand. There was no material income associated with the results of discontinued operations for the six-month period ending June 30, 2001.

Condensed and summarized balance sheet data for the discontinued operations of Antrim and HSII is summarized as follows, (in thousands):

	2001	2000
Assets:		
Current assets:		
Cash and cash equivalents	$ -	$ -
Accounts receivable	-	-
Other current assets	-	205
Total current assets	-	205
Property and equipment, net	-	-
Other and intangible assets, net	-	-
Total assets	$ -	$ 205
Liabilities:		
Current liabilities	70	4,338
Non-current liabilities	-	-
Total liabilities	70	4,338
Net liabilities of discontinued operations	$ 70	$ 4,133

QuadraMed created a wholly owned subsidiary named ChartOne, Inc. and transferred and assigned to ChartOne, Inc. the assets and liabilities of its ROI Division pursuant to the terms of an Asset Contribution Agreement dated May 3, 2000. On June 7, 2000, ChartOne, Inc., completed the sale of 2,520,000 shares of its Series A Preferred Stock to Warburg, Pincus Equity Partners, L.P. and certain of its affiliates, and Prudential Securities Group, Inc. for an aggregate purchase of $25.2 million representing 43% of the equity interest in ChartOne, Inc. The sale of the securities was made pursuant to the terms of the Securities Purchase Agreement, dated May 5, 2000. On October 19, 2000, QuadraMed sold its remaining 57% equity interest in ChartOne, Inc., represented by 2,130,000 shares of series B Preferred Stock, 1,200,000 shares of Series C Preferred Stock and 1 share of Common Stock to Warburg, Pincus Equity Partners, L.P. and certain of its affiliates, and Prudential Securities Group Inc. for an aggregate cash purchase price of $26.6 million pursuant to a Securities Purchase Agreement dated September 28, 2000. On the basis of these transactions, QuadraMed recorded a gain on the sale of ChartOne for the year ended December 31, 2000, of $23.3 million (net of income tax expense of $1.0 million).

Results of the ROI Division have been included in discontinued operations for all periods, as required by APB-30. For the six months ended June 30, 2000, results from discontinued operations, net of income taxes, were $1.5 million as follows, (in thousands):

	June 30, 2000
Revenues	$ 23,809
Costs and expenses	22,111
Gain from discontinued operations before income taxes	1,698
Provision for income taxes	(240)
Income from discontinued operations	$ 1,458

Net income from discontinued operations was immaterial for the six-month period ended June 30, 2001.

6. NON-RECURRING CHARGES

During the six-month-period ended June 30, 2001, QuadraMed recorded no non-recurring charges.

During the six months ended June 30, 2000, QuadraMed recorded approximately $28.3 million of non-recurring charges. The charges were primarily related to the discontinuation of the EnOvation product, the write-down of certain other receivables, payments to employees for severance agreements, costs associated with office closures and costs related to further product integration efforts and product consolidation. These charges also included a write-down of $10.6 million of HealthCast assets, as well as additional expenses of $5.3 million associated with

officers' separation agreements.

The following table sets forth QuadraMed's restructuring and non-specific litigation reserves and the activity against these reserves during the current six months ending June 30, 2001, (in thousands):

Description	Balance at December 31, 2000	Change (1)(2)	Balances at June 30, 2001
Restructure/Other.........	$ 3,206	$ (1,251)	$ 1,955
Non-Specific Legal........	1,616	(533)	1,083
Total reserves............	$ 4,822	$ (1,784)	$ 3,038

(1) Termination benefits included in restructuring/other payments during 2001 amounted to $0.7 million.

(2) Non-specific legal reserve was strengthened by $1.0 million during the quarter to cover potential litigation arising from acquisition related transactions.

7. INTANGIBLES

During the six months ended June 30, 2001, and 2000, amortization of intangibles was $3.3 million and $3.6 million, respectively. There were no charges or write-downs of intangible assets during the quarter ended June 30, 2001.

During the six-month period ending June 30, 2000, QuadraMed recorded a $0.9 million charge for the write-down of certain intangible assets determined to be impaired in accordance with SFAS No. 121, "Impairment of Long-Lived Assets." In addition, QuadraMed reclassified $3.6 million of intangible assets relating to Med Data to capitalized software.

8. CONTINGENCIES OR OTHER UNCERTAINTIES

From time to time in the normal course of its business, QuadraMed may be involved in litigation relating to its operations. As of June 30, 2001, QuadraMed was not a party to any legal proceedings that, if decided adversely, would, individually or in the aggregate, have a material adverse effect on QuadraMed's business, financial condition or results of operations.

9. INFORMATION ON BUSINESS SEGMENTS

QuadraMed reorganized its operations in 2000 to focus on five operating segments: Enterprise Products and Services Division, HIM Software Division, HIM Services Division, EZ Cap Division, and Financial Services Division. Although not reported as a business segment, QuadraMed also generated approximately five percent of its revenue from specialty product lines, discontinued or not aligned with an operating division, referenced as Other.

This reorganization was undertaken to more closely align products targeted to shared markets, to more accurately measure financial performance by product/division, and to establish greater management accountability. To this end, QuadraMed further refined its operating segments during the second quarter of 2001. As such, the segment results reflected in the exhibits below have been restated to reflect this realignment for both current and prior year data. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. QuadraMed evaluates financial performance by division as summarized in the subsequent table. The financial results for these operating segments for prior years have been restated on an estimated basis to conform with the current presentation.

QuadraMed's reportable segments are strategic business units that offer different products and services. Each segment, with its own unique position in the healthcare technology and services marketplace, provides customized expertise for the purchasers of healthcare IT and financial solutions.

The Enterprise Division consists of our Affinity Healthcare Information System and our Electronic Document Management product, which principally target acute care hospitals across the United States. The Affinity solution is a healthcare information system that provides financial and clinical applications. Affinity provides a patient-centered database designed to enable users to track each patient throughout the continuum of care in real time. Affinity integrates financial information such as patient accounting and DRG/case mix with clinical data such as medical charting and plan of care to automate federal and state reporting, scheduling, registration, and medical records information. This Division also includes our Electronic Document Management solution that enables users to create secure electronic patient folders that combine both computerized and scanned documents. Additionally, our Master Patient Index and Performance Measurement products were realigned into this division during the second quarter 2001. These products were previously reflected as part of the HIM Software Division.

The HIM Software Division represents a suite of compliance, encoding and grouping, medical record management, and patient database applications, which enable a hospital to accurately track medical records for internal and external purposes. The compliance products assist hospitals in managing the complexities of evolving federal requirements and in submitting accurate billing and clinical data. The coding and grouping solutions protect the integrity of a healthcare organization's clinical data and improve accuracy and coding compliance for ICD-9, CPT, and HCPCS codes. The medical record management product locates and reserves charts and authenticates and distributes transcribed medical records. During the second quarter 2001, the responsibility for nCoder+MD was transferred to this division from the EZ-Cap Division and as mentioned above, the Master Patient Index and Performance Measurement product lines previously reflected in this division were transferred to the Enterprise Division.

The HIM Services Division provides healthcare information management departments with experienced, qualified, and if necessary,

credentialed professionals to perform IT, coding, auditing, accounting, compliance, and medical record services. The Division also provides experienced executives for interim assignments in financial and management positions. These services are offered to acute care facilities as well as large physician, clinic, and ambulatory practices.

The EZ-CAP Division provides medical groups, independent practice associations, hospitals, and health plans with a complete managed care claims payment and management information system incorporating eligibility, plan benefits, providers, claims, capitation, case management, and customer service. This Division also includes education services, seminars, and training for healthcare organizations.

The Financial Services Division provides resources to healthcare providers to reduce accounts receivables' backlogs and accelerate cash flow. The Division conducts analysis of patient accounts to identify outstanding or underpaid third party payments, to re-bill, and to follow-up on third party claims.

SIX MONTHS ENDED JUNE 30, 2001
(in thousands)

Description	Enterprise	HIM Products	HIM Services	Financial Services	EZ Cap
Total revenues	$ 28,756	$ 13,014	$ 9,291	$ 6,706	$ 5,971
Direct margin(3)	$ 5,424	$ 4,873	$ 2,877	$ 2,672	$ 1,549
Interest income	689	286	316	220	120
Interest expense	(1,274)	(559)	(637)	(438)	(232
Interest income (expense), net	$ (585)	$ (273)	$ (321)	$ (218)	$ (112
Depreciation & amortization expense	$ 800	$ 3,007	$ 474	$ 211	$ 275
Benefit (provision) for income taxes	$ 37	$ 22	$ 21	$ (18)	$ (9
Segment earnings (loss)	$ (1,217)	$ (743)	$ (690)	$ 606	$ 311
Segment assets	$ 26,240	$ 54,023	$ 28,642	$ 6,341	$ 16,497

QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2001

SIX MONTHS ENDED JUNE 30, 2000
(in thousands)
(restated) (2)

Description	Enterprise	HIM Products	HIM Services	Financial Services	EZ Cap

Total revenues	$ 23,368	$ 10,440	$ 17,295	$ 5,868	$ 5,259
Direct margin(3)	$ 2,113	$ 739	$ 1,038	$ 781	$ 292
Interest income	501	174	71	62	98
Interest expense	(1,115)	(498)	(825)	(280)	(245)
Interest income (expense), net	$ (614)	$ (324)	$ (754)	$ (218)	$ (147
Depreciation & amortization expense	$ 560	$ 2,832	$ 579	$ 195	$ 393
Benefit (provision) for income taxes	$ 40	$ 117	$ 36	$ 19	$ 8
Segment earnings (loss)	$ 1,321	$ (3,912)	$ (1,185)	$ (639)	$ (273
Segment assets	$ 31,324	$ 42,963	$ 32,510	$ 8,202	$ 10,573

(1) All Other includes Specialty Division, Products being phased out and Corporate charges to ba charges.

(2) March 31, 2001 and prior results have been restated to be consistent with current period rec segments.

THREE MONTHS ENDED MARCH 31, 2001
(in thousands)
(restated) (2)

Description	Enterprise	HIM Products	HIM Services	Financial Services	EZ Ca
Total Revenues	$15,126	$ 4,901	$ 4,809	$ 3,049	$ 3,35
Direct margin(3)	$ 2,680	$ 1,296	$ 1,680	$ 931	$ 1,05
Interest income	215	90	112	74	3
Interest expense	(619)	(280)	(345)	(229)	(114
Interest income (expense), net	$ (404)	$ (190)	$ (233)	$ (155)	$ (77
Depreciation & amortization expense	$ 446	$ 1,503	$ 239	$ 104	$ 143
Benefit (provision) for income taxes	$ 18	$ 43	$ 11	$ 5	$ (12
Segment earnings (loss)	$ (588)	$(1,423)	$ (355)	$ (154)	$ 39
Segment assets	$30,150	$ 48,482	$ 30,571	$ 6,420	$19,03

QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2001

THREE MONTHS ENDED MARCH 31, 2000
(in thousands)
(restated) (2)

Description	Enterprise	HIM Products	HIM Services	Financial Services	EZ Cap
Total revenues	$10,944	$ 4,337	$ 9,515	$ 2,870	$ 2,862
Direct margin(3)	$ (479)	$(1,176)	$ 343	$ 64	$ 150
Interest income	240	62	44	30	51
Interest expense	(547)	(217)	(476)	(143)	(137)
Interest income (expense), net	$ (307)	$ (155)	$ (432)	$ (113)	$ (86)
Depreciation & amortization expense	$ 262	$ 1,310	$ 285	$ 90	$ 191
Benefit (provision) for income taxes	$ 22	$ 73	$ 7	$ -	$ 4
Segment earnings (loss)	$ (731)	$(2,432)	$ (249)	$ 1	$ (124
Segment assets	$43,089	$46,513	$39,164	$ 7,691	$12,142

(1) All Other includes Specialty Division, Products being phased out and Corporate charges to ba
charges.
(2) March 31, 2001 and prior results have been restated to be consistent with current period rec
segments.
(3) Direct margin represents segment results before interest, depreciation, amortization, taxes

10. SUBSEQUENT EVENTS.

On August 3, 2001, QuadraMed announced that James D. Durham, its founder and a member of the Company's Board of Directors, had resigned from the Board.

11. RECENT ACCOUNTING PRONOUNCEMENTS.

QuadraMed adopted The Financial Accounting Standards Board (FASB) Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities - An Amendment of FASB Statement No. 133," effective January 1, 2001. Because of QuadraMed's limited use of derivative instruments, QuadraMed has elected not to account for its derivative instruments as hedges. Accordingly, upon adoption, the fair values of derivative instruments will be recorded as assets or liabilities on the balance sheet, and changes in fair values of these instruments beyond normal sales and purchases will be reflected in current income. QuadraMed may elect to apply hedge accounting, which has different financial statement effects, to possible future transactions

involving derivative instruments, if significant. Such an election would reduce earnings volatility that might otherwise result if changes in fair values were recognized in current income. The adoption of SFAS No. 133 and SFAS No. 138 did not have a significant impact on QuadraMed's results of operations or financial position.

In September 2000, the FASB issued Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - A Replacement of FASB Statement No. 125" ("SFAS No. 140"). SFAS No. 140 is effective for transfers occurring after March 31, 2001, and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. SFAS No. 140 has no significant effect on QuadraMed's accounting or disclosures for the types of transactions within the scope of the new standard.

12. ACCOUNTING PRONOUNCEMENTS TO BE ADOPTED.

In June 2001, the FASB issued statement No. 141 "Business Combinations". The statement addresses financial accounting and reporting for business combinations and supercedes APB Opinion No. 16, Business Combinations, and FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises. All business combinations within the scope of this Statement are to be accounted for using one method, the purchase method. The provisions of this Statement apply to all business combinations initiated after June 30, 2001. The adoption of the new Statement is not expected to have a material effect on the Company's financial position, results of operations, or cash flows.

In June 2001, the FASB issued statement No. 142 "Goodwill and Other Intangible Assets". The statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supercedes APB Opinion No. 17, Intangible Assets. SFAS No. 142 addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in business combination) should be accounted for in financial statements upon acquisition. In addition, this statement addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. The provisions of SFAS No. 142 are required to be applied starting with fiscal years beginning after December 15, 2001. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cashflows.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this Quarterly Report on Form 10-Q, QuadraMed and its management discuss and make statements regarding their intentions, beliefs, and current expectations regarding QuadraMed's future operations and performance. Such statements are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are often identified by words such as "anticipates," "believes," "expects," "will," "should" and "intends" and their negatives. QuadraMed and its management caution prospective investors that such forward-looking statements are not guarantees of future performance. Risks and uncertainties are inherent in QuadraMed's future performance. QuadraMed and its management make forward-looking statements based on currently available information and assume no obligation to update these statements due to changes in underlying factors, new information, future developments, or otherwise.

Risks and uncertainties that could cause QuadraMed's actual

results to differ from these forward-looking statements are discussed in Item 3 entitled, "Quantitative and Qualitative Disclosures About Market Risk."

Overview

QuadraMed is a healthcare information technology leader with software, web-enabled solutions, and professional consulting services that enable hospitals and providers to efficiently and effectively manage their delivery of healthcare. It has over one hundred products and services facilitating all facets of healthcare information management, including clinical, patient, financial, compliance, and managed care. QuadraMed supports more than half of the U.S. hospitals and support global healthcare initiatives with a dedicated staff of over 1000 professionals. QuadraMed was reincorporated in Delaware in 1996 after having been originally incorporated in California in 1993.

QuadraMed has undergone a number of key financial and operational improvements since June 2000, focused on integrating the large number of acquisitions carried out from 1993 to 1999. As part of this strategy, QuadraMed has reduced expenses, sold non-strategic assets for cash, settled outstanding litigation, made several management changes, and re-aligned its organization into five operating divisions:

- Enterprise Products and Services Division, which provides acute care hospitals with integrated enterprise information systems to manage patient registration, clinical, and financial information.

- Health Information Management Products Division, which provides software products that automate and support hospital and provider health information management departments in maintaining accurate and timely patient treatment information and coding for appropriate reimbursement.

- Financial Services Division, which identifies and collects accounts receivables for hospitals and medical groups.

- Health Information Management Services Division, which provides (1) health information interim management, management consulting and department outsourcing services; (2) coding, compliance, and education services; (3) compliance, legal, and regulatory services; and (4) charge description master reviews.

- EZ-CAP Division, which provides (1) software designed to support managed care risk-taking organizations, such as medical groups, physician-health organizations, independent practice associations, and medical service organizations; and (2) seminars for doctors and medical professionals.

In the second quarter of 2001, QuadraMed announced that it was increasing its sales force and embarking on a product development strategy intended to add new clinical functionality to its AFFINITY(R) product in the Enterprise Products and Services Division and to improve the overall performance of its Coding, Abstracting and Compliance products in the Health Information Management Division.

Revenues

Licenses. License revenues include license, installation, consulting and post-contract support fees, third-party hardware sales and

other revenues related to licensing of QuadraMed's software products. License revenues for the quarter ended June 30, 2001, were $23.0 million, compared to $22.9 million in the same period last year. For six months ended June 30, 2001, license revenues increased 10.7% to $45.5 million compared to $41.1 million in the same period last year. The increase in license revenues was principally attributable to increased sales of Affinity and HIM software products.

Services. Service revenues for the quarter ended June 30, 2001, were $10.6 million, compared to $13.4 million in the same period last year. For the six months ended June 30, 2001, service revenues decreased 26.1% to $21.0 million, compared to $28.4 million in the same period last year. The decrease in service revenues was principally due to termination of service contracts dating back to the second half of 2000.

Cost of Revenues

Cost of Licenses. Cost of licenses consists primarily of salaries, benefits and allocated costs related to software installations, hardware costs, customer support and royalties to third parties. Cost of licenses for the quarter ended June 30, 2001 were $6.2 million, 13.8% more than $5.4 million in the same period last year. As a percentage of license revenues, cost of licenses were 26.8% for the quarter ended June 30, 2001, compared with 23.7% in the same period last year. For the six months ended June 30, 2001, cost of license revenues increased 0.6% to $12.5 million, compared to $12.4 million in the same period last year. As a percentage of license revenues, cost of licenses were 27.6% in the six months ended June 30, 2001, compared with 30.3% in the same period last year. The decrease in the year to date cost of licenses is driven by the 10.7% revenue growth and the essentially flat cost of sales.

Cost of Services. Cost of services includes expenses associated with services performed in connection with health information management and financial services, compliance and consulting services. Cost of services for the quarter ended June 30, 2001 were $4.9 million, 54.1% less than $10.7 million in the same period last year. As a percentage of service revenues, cost of services were 46.3% for the quarter ended June 30, 2001, compared with 80.0% in the same period last year. For the six months ended June 30, 2001, cost of service revenues decreased 53.6% to $9.6 million, compared to $20.7 million in the same period last year. As a percentage of service revenues, cost of services were 45.8% in the six months ended June 30, 2001, compared with 73.0% in the same period last year. The decrease in the year to date cost of services is driven by tighter control of expenses and the elimination of some hospital service contracts that had a high cost of service.

Operating Expenses

QuadraMed was realigned from a functional structure in 2000 to operating divisions in 2001, and with the revised definitions for Cost of Licenses and Cost of Services, the 2000 expenses have been reclassed to conform to the current reporting segments. The expense comparisons by category are based upon estimates for 2000. For this reason, although the total operating expenses are substantially lower than the prior year, the comparisons by expense category are also estimates.

General and Administration. General and administration expenses for the quarter ended June 30, 2001, were $12.9 million, greater than the $10.7 million in the same period last year. As a percentage of total revenues, general and administration expenses were 38.2% for the quarter ended June 30, 2001, compared to 29.5% in the same period last year. For the six months ended June 30, 2001, general and administration expenses of

$26.7 million were 7.2% above the $24.9 million in the same period last year. As a percentage of total revenues, general and administration expensese increased to 40.2% for the six months ended June 30, 2001, from 35.8% in the same period last year. General and administration expenses increased primarily as a result of strengthening of incentive compensation accruals and bad debt reserves. On a sequential basis, General and Administrative costs declined for the third consecutive quarter.

Sales and Marketing. Sales and marketing expenses for the quarter ended June 30, 2001, were $4.0 million, 39.1% less than $6.6 million in the same period last year. As a percentage of total revenues, sales and marketing expenses were 12.0% for the quarter ended June 30, 2001, compared to 18.2% in the same period last year. For the six months ended June 30, 2001, sales and marketing expenses decreased 38.3% to $7.9 million, compared to $12.7 million in the same period last year. As a percentage of total revenues, sales and marketing decreased to 11.8% for the six months ended June 30, 2001, from 18.3% in the same period last year. On a sequential basis, sales and marketing expenses increased over last quarter, reflecting the addition of sales staff for the Enterprise and HIM divisions.

Research and Development. Research and development expenses for the quarter ended June 30, 2001, were $3.8 million, 32.8% less than $5.7 million in the same period last year. As a percentage of total revenues, research and development costs were 11.3% for the quarter ended June 30, 2001, compared to 15.6% in the same period last year. For the six months ended June 30, 2001, research and development expenses decreased 36.3% to $7.3 million, compared to $11.5 million in the same period last year. As a percentage of total revenues, research and development expenses decreased to 11.0% for the six months ended June 30, 2001, from 16.5% in the same period last year. Research and development expenses decreased year over year primarily as a result of a reduction in product versions and associated maintenance requirements, however, the level of research and development increased sequentially over the first quarter of 2001 as the Company increased development spending on its Affinity and coding compliance products.

QuadraMed believes that research and development expenditures are essential to maintaining its competitive position. As a result, QuadraMed intends to continue to make investments in the development of new products and in the further integration of acquired technologies.

Amortization of Intangibles. Amortization of intangibles for the quarter ended June 30, 2001, increased 16.9% to $1.7 million, compared to $1.4 million in the same period last year. For the six months ended June 30, 2001, amortization of intangibles decreased 7.3% to $3.3 million compared to $3.6 million in the same period last year. The year to date decrease resulted from an analysis of the underlying asset and related amortization rates.

Acquisition Costs. There were no acquisition charges for the three and six months ended June 30, 2001, and 2000.

Non-Recurring Charges. There were no non-recurring charges for the three and six months ended June 30, 2001.

During the six months ended June 30, 2000, QuadraMed recorded approximately $28.3 million of non-recurring charges. Those charges were primarily related to the sunsetting of the EnOvation product, the write-down of certain other receivables, and payments to employees for severance agreements and costs associated with office closures. In addition, there were costs related to further product integration efforts

and product consolidation.

Interest Expense. Interest expense was $1.6 and $3.3 million for the three and six month periods ending June 30, 2001, compared to $1.7 and $3.3 million for the same period last year. Interest expense in 2001 and 2000 was principally related to QuadraMed's $115.0 million convertible subordinated debentures, which were issued in May 1998, partially offset by interest income from QuadraMed's cash and investments.

Liquidity and Capital Resources

At June 30, 2001, QuadraMed had $42.8 million in cash and cash equivalents, compared to $27.4 million at December 31, 2000.

In October 1996, QuadraMed completed its initial public offering of common stock, which resulted in net proceeds of approximately $26.4 million. In October 1997, QuadraMed completed a follow-on offering of common stock, which resulted in net proceeds of approximately $57.3 million. In April 1998, QuadraMed completed an offering of $115.0 million principal amount of convertible subordinated debentures, including the initial purchasers' over-allotment option. The debentures are due May 1, 2005, and bear interest, which is payable semi-annually at 5.25% per annum. Proceeds from the offering were $110.8 million.

In May 2001, QuadraMed redeemed $5.4 million in face value of convertible subordinated debentures at prices ranging from $53.00 to $53.75. The Company recognized an extraordinary gain of $2.4 million after applicable taxes as a result of the early extinguishment of debt.

Net cash provided by (used in) operating activities was $9.2 million and ($6.3) million for the six months ended June 30, 2001, and 2000, respectively. Net cash provided by operating activities for the six months ended June 30, 2001 principally reflected the improvement in collections on receivable balances and the lower operating expenses. Net cash used in operating activities for the six months ended June 30, 2000, related to the write-down on certain intangible assets and accounts receivable and the sale of division.

Net cash provided by investing activities was $11.9 million and $11.3 million for the six months ended June 30, 2001 and 2000, respectively. Investing activities for the six months ended June 30, 2001 primarily related to the maturity of available-for-sale short-term investments and release of restricted cash. Net cash provided by investing activities for the six months ended June 30, 2000 primarily related to proceeds from the sale of division and the maturity of available-for-sale short-term investments.

Net cash (used in) provided by financing activities was ($5.7) million and $0.9 million for the six months ended June 30, 2001, and 2000, respectively. Net cash used in financing activities for the six months ended June 30, 2001, primarily related to the redemption of convertible subordinated debentures and capital lease obligations. Net cash provided by financing activities for the six months ended June 30, 2000, primarily related to the issuance of common stock through the Employee Stock Purchase Plan and the proceeds from the exercising of common stock options.

QuadraMed believes that its cash and investments and borrowing capacity on June 30, 2001, is sufficient to fund operations at least through December 31, 2001.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS.

Interest Rate Risk

QuadraMed's exposure to market risk for changes in interest rates primarily relates to its investment portfolio and its convertible subordinated debentures. QuadraMed intends to ensure the safety and preservation of its invested principal funds by limiting default risk, market risk and reinvestment risk. QuadraMed invests in high-quality issuers, including money market funds, corporate debt securities, and debt securities issued by the United States government. QuadraMed has a policy of investing in securities with maturities of two years or less. QuadraMed does not invest in derivative financial or foreign investments. The table below presents fair values of principal amounts and weighted average interest rates for QuadraMed's investment portfolio as of June 30, 2001, (in thousands, except average interest rates):

	Aggregate Fair Value	Weigh Inte
Cash and cash equivalents:		
Cash	$ 3,282	
Money market funds	$ 39,550	
Total cash and cash equivalents	$ 42,832	
Short-term investments:		
Corporate debt securities	$ 34	
Debt securities issued by the U.S. government	$ 34	
Other short-term investment	$ 2,380	
Total short-term investments	$ 2,448	
Long-term investments:		
Corporate debt securities	$ 503	
Debt securities issued by the U.S. government	$ 558	
Total long-term investments	$ 1,061	

Outstanding Debt. As of June 30, 2001, QuadraMed had outstanding long-term debt of $109,615, consisting of (in thousands, except average interest rates):

	Six Months Ended June 30, 2001			
	Carrying Amount	Fair Value	Maturity Date	Weig Int
Convertible Subordinated Debentures (1)	$ 109,615	$ 70,702	2005	

(1) In May 2001, QuadraMed redeemed $5.4 million in face value of convertible subordinated d $53.00 to $53.75 and recognized an extraordinary gain of $2.4 million after applicable t

early extinguishment of debt.

Long-term debt is carried at the original offering price, less any payments of principal. The debentures are unsecured, subordinated to all senior indebtedness and convertible at any time into shares of the Company's common stock. The debentures will mature on May 1, 2005, and are redeemable, in whole or in part, at the option of the Company. In order to estimate the fair value of these debentures, the Company used currently quoted market prices.

QuadraMed is not exposed to material changes in interest rate because the interest rate on its convertible subordinated debentures, the bulk of QuadraMed's debt, is fixed at 5.25%.

Foreign Currency Risk

Although QuadraMed from time to time sells its products internationally, all such transactions are denominated in U.S. currency and there is no foreign currency fluctuation risk.

QuadraMed has encountered significant challenges integrating acquired businesses, and its business, operations, and financial condition have been adversely affected.

Since its inception, QuadraMed has completed twenty-eight (28) acquisitions. QuadraMed has encountered significant challenges related to integrating acquired businesses into its operations and expects these challenges to continue until incorporation is complete. Some of the challenges QuadraMed has encountered or may encounter in integrating acquired businesses include:

- Interruption, disruption or delay of QuadraMed's ongoing business;
- Distraction of management's attention from other matters;
- Additional operational and administrative expense;
- Difficulty managing geographically dispersed operations;
- Failure of acquired businesses to achieve expected results resulting in failure of QuadraMed to realize anticipated benefits;
- Failure to retain key acquired personnel and difficulty and expense of training those retained;
- Increases in stock compensation expense and increased compensation expense resulting from newly hired employees;
- Assumption of liabilities of acquired businesses and potential for disputes with the sellers;
- Customer dissatisfaction or performance problems related to acquired businesses;
- Exposure to the risks of entering markets in which QuadraMed has no direct prior experience and to risks associated with market acceptance of acquired products and technologies; and
- Platform and technical issues related to integrating systems

from various acquired companies.

All of these factors have had, and QuadraMed expects will continue to have, an adverse effect on its business, financial condition and results of operations at least until the integration of the acquired businesses is complete. In addition, these problems have led QuadraMed to refocus its business strategy away from acquisitions, which could lead to slower future growth and negatively impact its financial condition.

QuadraMed has incurred losses in each of the past three years and could continue to incur losses in future periods.

QuadraMed incurred net losses of $54.8 million, $12.3 million, and $21.4 million in 2000, 1999, and 1998, respectively, and a net gain of $1.7 million for the quarter ended June 30, 2001, and a net loss of $1.3 for the six months ended June 30, 2001. As of June 30, 2001, QuadraMed's accumulated deficit was $261.6 million. Included in these losses are the effect of both operating losses and write-offs for in-process research and development of $1.7 million and $14.5 million in 1999 and 1998, respectively. No in-process research and development write-offs occurred in 2000, or in the quarter ended June 30, 2001. Furthermore, in connection with its acquisitions, QuadraMed may be required to amortize significant expenses related to goodwill and other intangible assets in future periods. Accordingly, if QuadraMed's operating results do not improve to offset these and other expenses, QuadraMed may continue to experience losses in future periods and may never be profitable.

QuadraMed's quarterly operating results are subject to fluctuations, which could adversely affect its net income and financial results.

QuadraMed's quarterly operating results have varied significantly in the past and may fluctuate significantly in the future as a result of a variety of factors, many of which are outside its control. Accordingly, quarter-to-quarter comparisons of QuadraMed's operating results may not be a good indication of QuadraMed's future performance. Some of the factors causing these fluctuations include:

- Variability in demand for products and services;
- Introduction of product enhancements and new products by QuadraMed and its competitors;
- Timing and significance of announcements concerning present or prospective strategic alliances;
- Divestiture of discontinuation of, or reduction in, the products and services QuadraMed offers;
- Loss of customers due to consolidation in the healthcare industry;
- Delays in product delivery requested by its customers;
- Customer budget cycle fluctuation;
- Investment in marketing, sales, research and development, and administrative personnel necessary to support anticipated operations;
- Costs incurred for marketing and sales promotional activities;

- Software defects and other product quality factors;
- General economic conditions and their impact on the healthcare industry;
- Cooperation from competitors on interfaces and implementation when a customer chooses systems from various vendors;
- Delays in implementation due to product readiness or to customer induced delays in training or installation;
- Final negotiated sales prices of systems;
- Federal regulations (i.e., OIG, HIPAA, ICD-10) that can increase demand for new, updated systems;
- Federal regulations that directly affect reimbursements received, and therefore the amount of money available for purchasing information systems; and
- The fines and penalties a healthcare provider or system may incur due to fraudulent billing practices.

QuadraMed's operating expense levels, which increase with the addition of acquired businesses, are relatively fixed. Accordingly, if future revenues are below expectations, QuadraMed would experience a disproportionate adverse affect on its net income and financial results. In the event of a revenue shortfall, QuadraMed will likely be unable to, or may elect not to, reduce spending quickly enough to offset any such shortfall. As a result, it is possible that QuadraMed's future revenues or operating results may fall below the expectations of securities analysts and investors. In such a case, the price of QuadraMed's publicly traded securities may be adversely affected.

The variability and length of QuadraMed's sales cycle for its products may exacerbate the unpredictability and volatility of QuadraMed's operating results.

QuadraMed cannot accurately forecast the timing of its customer purchases due to the complex procurement decision processes of most healthcare providers and payors. How and when to implement, replace, expand or substantially modify an information system are major decisions for customers, and such decisions require significant capital expenditures by them. As a result, QuadraMed typically experiences sales cycles that extend over several quarters and QuadraMed has only a limited ability to forecast the timing and size of specific sales, making the prediction of quarterly financial performance more difficult.

QuadraMed may not be able to hire and retain necessary qualified personnel and the uncertainty caused by QuadraMed's management changes could adversely affect the price of its Common Stock.

In large part, QuadraMed's future success will depend upon its ability to attract and retain executive officers, product managers, and other key sales, marketing and development personnel. Competition for personnel in the software and healthcare information management industry is intense. At times, QuadraMed has had difficulty attracting and retaining highly qualified candidates within specific geographic areas or with specific industry experience. If QuadraMed's competitors increase their use of valid non-compete agreements, the pool of candidates may narrow in some geographic areas. The failure to attract, retain, train, and effectively

manage personnel could increase QuadraMed's costs and impair its development, sales, and customer service efforts.

Changes in procurement practices of hospitals have and may continue to have a negative impact on QuadraMed's revenues.

A substantial portion of QuadraMed's revenues has been and is expected to continue to be derived from sales of software products and services to hospitals. Consolidation in the healthcare industry, particularly in the hospital and managed care markets, could decrease the number of existing or potential purchasers of products and services and could adversely affect QuadraMed's business. In addition, the decision to purchase QuadraMed's products often involves a committee approval. Consequently, it is difficult for QuadraMed to predict the timing or outcome of the buying decisions of its customers or potential customers. In the quarter ended June 30, 2001, QuadraMed's service revenues decreased due to the loss of hospital service contracts. In addition, many healthcare providers are consolidating to create integrated healthcare delivery systems with greater regional market power. These emerging systems could have greater bargaining power, which may lead to decreases in prices for QuadraMed's products, which could adversely affect QuadraMed's business, financial condition and results of operations.

Changes in the healthcare financing and reimbursement system could adversely affect the amount of and manner in which QuadraMed's customers purchase its products and services.

Changes in current healthcare financing and reimbursement systems could result in unplanned product enhancements, delays or cancellations of product orders or shipments or reduce the need for certain systems. QuadraMed could also have the endorsement of products by hospital associations or other customers revoked. Any of these occurrences could have a material adverse effect on QuadraMed's business.

The healthcare industry in the United States is subject to changing political, economic and regulatory influences that may affect the procurement practices and operations of healthcare organizations. The commercial value and appeal of QuadraMed's products may be adversely affected if the current healthcare financing and reimbursement system were to revert to a fee-for-service model. In addition, many of QuadraMed's customers provide services under capitated service agreements, and a reduction in the use of capitation arrangements as a result of regulatory or market changes could have a material adverse effect on QuadraMed's business. During the past several years, the healthcare industry has been subject to increasing levels of governmental regulation of, among other things, reimbursement rates and capital expenditures. Proposals to reform the healthcare system have been and are being considered by the United States Congress. These proposals, if enacted, could change the operating environment of QuadraMed's customers in ways that cannot be predicted. Healthcare organizations may react to these proposals by curtailing or deferring investments, including those for QuadraMed's products and services. In addition, the regulations promulgated under HIPAA could lead healthcare organizations to curtail or defer investments in non-HIPAA related features in the next several years.

If QuadraMed is unable to compete effectively, it could experience price reduction, reduced gross margins and loss of market share.

Competition for QuadraMed's products and services is intense. Increased competition could result in reductions in QuadraMed's prices, gross margins, and market share and have a material adverse affect on QuadraMed's business, financial condition and results of operations.

QuadraMed competes with other providers of healthcare information software and services, as well as healthcare consulting firms. Some competitors have formed business alliances with other competitors that may affect QuadraMed's ability to work with some potential customers. In addition, if some of QuadraMed's competitors merge, a stronger competitor may emerge. Some principal competitors include:

- McKesson HBOC, Inc., SoftMed Corporation Inc., FileNet, Lanvision, MedPlus, and Eclipsys Corporation in the market for electronic document management products in the Enterprise Products and Services Division; o Eclipsys Corporation, Healthcare Microsystems, Inc., a division of Health Management Systems Inc., McKesson HBOC, Shared Medical Systems, Inc., a division of Siemens, and MediQual Systems, Inc., a division of Cardinal Health, Inc., in the market for decision support products in the Enterprise Products and Services Division;

- McKesson HBOC, Inc., Shared Medical Systems, Inc., a division of Siemens, MediTech Corporation, Eclipsys Corporation, Cerner, and IDX/Phamis in the market for enterprise healthcare information systems in the Enterprise Products and Services Division;

- Madison, McKesson HBOC, Shared Medical Systems, Inc., a division of Siemens, and Medibase in the market for MPI products and services in the Enterprise Products and Services Division;

- 3M, SoftMed Corporation, Inc., MetaHealth, Eclypsis Corporation, Cascade, and HSS in the market for medical records products in the Health Information Management Product Division;

- PriceWaterhouseCoopers, KPMG and Ernst and Young for compliance products and services and health information management consulting services in the Health Information Management Services Division;

- Physmark, Perot System's Health System Design, Healtheon/WebMD's Medical Manager Corp., IDX Corporation and Trizetto's Erisco, for at-risk managed care systems in the EZ-CAP Division; and

- National consulting firms and on-line providers for physician and other medical professional seminars in the EZ-CAP Division.

Current and prospective customers evaluate QuadraMed's capabilities against the merits of their existing information systems and expertise. Furthermore, major software information systems companies, including those specializing in the healthcare industry, that do not presently offer competing products may enter QuadraMed's markets. Many of QuadraMed's competitors and potential competitors have significantly greater financial, technical, product development, marketing and other resources and market recognition than QuadraMed. Many of these competitors also have, or may develop or acquire, substantial installed customer bases in the healthcare industry. As a result of these factors, QuadraMed's competitors may be able to respond more quickly to new or emerging technologies, changes in customer requirements, and changes in the political, economic or regulatory environment in the healthcare industry. These competitors may be in a position to devote greater resources to the

development, promotion and sale of their products than QuadraMed. QuadraMed may not be able to compete successfully against current and future competitors, and such competitive pressures could materially adversely affect QuadraMed's business, financial condition and operating results.

QuadraMed may not be able to introduce or market new products or product enhancements successfully or in a timely manner, which could adversely affect its competitive position.

QuadraMed's performance depends in large part upon its ability to provide the increasing functionality required by its customers through the timely development and successful introduction of new products and enhancements to its existing suite of products. QuadraMed may not successfully, or in a timely manner, develop, acquire, integrate, introduce, or market new products or product enhancements. Product enhancements or new products developed by QuadraMed also may not meet the requirements of hospitals or other healthcare providers and payors or achieve or sustain market acceptance. QuadraMed's failure to either estimate accurately the resources and related expenses required for a project, or to complete its contractual obligations in a manner consistent with the project plan upon which a contract was based, could have a material adverse effect on its business, financial condition and results of operations. In addition, QuadraMed's failure to meet a customer's expectations in the performance of its services could damage its reputation and adversely affect QuadraMed's ability to attract new business.

QuadraMed's inability to protect its intellectual property could lead to unauthorized use of its products, which could have an adverse effect on its business.

QuadraMed relies on a combination of trade secret, copyright and trademark laws, nondisclosure, noncompete and other contractual provisions to protect its proprietary rights. QuadraMed has not filed any patent applications covering its technology. Measures taken by QuadraMed to protect its intellectual property may not be adequate, and QuadraMed's competitors could independently develop products and services that are substantially equivalent or superior to QuadraMed's products and services. Any infringement or misappropriation of its proprietary software and databases could put QuadraMed at a competitive disadvantage in a highly competitive market and could cause QuadraMed to lose revenues, incur substantial litigation expense and divert management's attention from other operations.

QuadraMed depends on licenses for certain technology used to develop its products from a number of third-party vendors. Most of these licenses expire within three to five years. Such licenses can be renewed only by mutual consent and may be terminated if QuadraMed breaches the license terms and fails to cure the breach within a specified time period. If such licenses are terminated, QuadraMed may not be able to continue using the technology on commercially reasonable terms or at all. As a result, QuadraMed may have to discontinue, delay or reduce product shipments until equivalent technology is obtained, which could have a material adverse effect on QuadraMed's business, financial condition and results of operations. Most of QuadraMed's third-party licenses are non-exclusive and competitors may obtain the same or similar technology. In addition, if vendors choose to discontinue support of the licensed technology, QuadraMed may not be able to modify or adapt its products.

Intellectual property litigation is increasingly common in the software industry. The risk of an infringement claim against QuadraMed may increase over time as the number of competitors in its industry segment grows and the functionality of products overlaps. Third parties could

assert infringement claims against QuadraMed in the future. Regardless of the merits, QuadraMed could incur substantial litigation expenses in defending any such asserted claim. In the event of an unfavorable ruling on any such claim, a license or similar agreement may not be available to QuadraMed on reasonable terms, if at all. Infringement may also result in significant monetary liabilities that could have a material adverse effect on QuadraMed's business, financial condition and results of operations. QuadraMed may not be successful in the defense of these or similar claims.

The nature of QuadraMed's products makes them particularly vulnerable to undetected errors, or bugs, that could reduce revenues, market share or demand for the company's products and services.

Products such as QuadraMed's may contain errors or failures, especially when initially introduced or when new versions are released. Although QuadraMed conducts extensive testing on its products, software errors have been discovered in certain enhancements and products after their introduction. Despite such testing by QuadraMed and by its current and potential customers, products under development, enhancements, or shipped products may contain errors or performance failures, resulting in, among other things:

- loss of customers and revenues;
- delay in market acceptance;
- diversion of resources;
- damage to QuadraMed's reputation; or
- increased service and warranty costs.

Any of these consequences could have a material adverse effect on QuadraMed's business, financial condition, and results of operations.

Because no mirror processing site for its two customer data processing facilities exists, QuadraMed's business, financial condition, and results of operations could be adversely affected if either of these facilities were subject to a closure from a catastrophic event or otherwise.

QuadraMed currently processes substantially all of its customer data at its facilities in Neptune, New Jersey. Although QuadraMed backs up its data nightly and has safeguards for emergencies, such as power interruption or breakdown in temperature controls, QuadraMed has no mirror processing site to which processing could be transferred in the case of a catastrophic event at either of these facilities. If a major catastrophic event occurs at the Neptune facility, possibly leading to an interruption of data processing, or any other interruption or closure, QuadraMed's business, financial condition, and results of operations could be adversely affected.

If QuadraMed products become subject to FDA regulation, QuadraMed may be required to make substantial product changes that could require a significant capital investment.

Computer products used or intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease or other conditions or that affect the structure or function of the body are subject to regulation by the FDA under the Federal Food, Drug and Cosmetic Act. At present, none of QuadraMed's software products are so regulated. In the future, the FDA could determine that some of QuadraMed's products, because of their predictive aspects, are clinical decision tools and subject them to regulation. Compliance with FDA regulations could be burdensome, time

consuming, and expensive. Other new laws and regulations affecting healthcare software development and marketing also could be enacted in the future. If so, it is possible that QuadraMed's costs and lengths of time for product development and marketing could increase and that other unforeseeable consequences could arise.

Governmental regulation of the confidentiality of patient records could result in QuadraMed's customers being unable to use its products without significant modification, which could require substantial expenditures by QuadraMed.

There is substantial state regulation of the confidentiality of patient medical records and the circumstances under which such records may be disclosed to or processed by QuadraMed as a consequence of its contacts with various health providers. Although compliance with these laws and regulations is presently the principal responsibility of the hospital, physician or other healthcare provider, regulations governing patient confidentiality rights are rapidly evolving. Additional legislation governing the dissemination of medical record information also has been proposed and may be adopted at the state level.

HIPAA and, in particular, its administrative simplification provisions, require the promulgation of regulations that will set standards for electronic transactions, code sets, data security, unique identification numbers, and privacy of individually identifiable health information. The regulations are in various stages of development. A final regulation governing transaction and code set standards has been published and is expected to become effective on October 16, 2002. The privacy regulation has been published as a final regulation and became effective on April 14, 2001. The HIPAA privacy regulation is complex and far reaching. Compliance will be required of certain covered entities, including healthcare providers, health plans, and healthcare clearinghouses. QuadraMed may be implicated by these regulations either as a covered entity or as a business associate of a covered entity. The HIPAA and state healthcare privacy regulations could materially restrict the ability of healthcare providers to submit information from patient records using QuadraMed products and services or could require QuadraMed to make substantial capital expenditures to be in compliance.

HIPAA's data security regulation has been published as a proposal. At this time, no information is available on when the regulation will be published as final or whether the regulation will be revised prior to final publication. At this time, it is not possible to assess the specific implications of the security regulation on QuadraMed. The regulation may require holders of individual personal healthcare information, including QuadraMed, to implement stringent security measures. Implementing such measures may require substantial capital expenditures by QuadraMed due to required product, service, and procedure changes.

In addition, during the past several years, the healthcare industry has been subject to, among other things, increasing levels of governmental regulation of reimbursement rates and certain capital expenditures. Certain proposals to reform the healthcare system have been and are being considered by Congress. These proposals, if enacted, could change the operating environment for QuadraMed's clients in ways that could have a negative impact on QuadraMed's business, financial condition and results of operations. QuadraMed is unable to predict what, if any, changes will occur.

If QuadraMed's products fail to accurately assess, process, or collect healthcare claims or administer managed care contracts, QuadraMed could be subject to costly litigation and be forced to make costly changes to its

products.

Some of QuadraMed's products and services are used in the payment, collection, coding and billing of healthcare claims and the administration of managed care contracts. If QuadraMed's employees or QuadraMed's products fail to accurately assess, process or collect these claims, customers could file claims against QuadraMed. QuadraMed's insurance coverage may not adequately cover such claims. A successful claim that is in excess of, or is not covered by, insurance coverage could adversely affect QuadraMed's business, financial condition, and results of operations. Even a claim without merit could result in significant legal defense costs and could consume management time and resources. In addition, claims could increase QuadraMed's premium such that appropriate insurance could not be found at commercially reasonable rates. Furthermore, if QuadraMed were found liable, QuadraMed may have to significantly alter one or more of its products, possibly resulting in additional unanticipated research and development expenses.

Provisions in QuadraMed's certificate of incorporation and bylaws and Delaware law could delay or discourage third parties from acquiring QuadraMed at a premium, which could adversely affect the price of its Common Stock.

QuadraMed's board of directors has the authority to issue up to 5,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by holders of QuadraMed's Common Stock. If preferred stock is issued, the voting and other rights of the holders of QuadraMed's Common Stock may be subject to, and may be adversely affected by, the rights of the holders of QuadraMed's preferred stock. The issuance of preferred stock may have the effect of delaying or preventing a change of control of QuadraMed that would have been at a premium price to QuadraMed's stockholders.

Certain provisions of QuadraMed's certificate of incorporation and bylaws could discourage potential takeover attempts and make attempts by stockholders to change management difficult. For example, QuadraMed's board of directors, which is classified into three classes of directors serving staggered, three-year terms, has the authority to impose various procedural and other requirements that could make it more difficult for QuadraMed's stockholders to effect certain corporate actions. In addition, QuadraMed's certificate of incorporation provides that directors may be removed only by the affirmative vote of the holders of two-thirds of the shares of QuadraMed's capital stock entitled to vote. Any vacancy on QuadraMed's board of directors may be filled only by vote of the majority of directors then in office. Further, QuadraMed's certificate of incorporation provides that the affirmative vote of two-thirds of the shares entitled to vote, voting together as a single class, subject to certain exceptions, is required for certain business combination transactions. These provisions, and certain other provisions of QuadraMed's certificate of incorporation, could have the effect of delaying or preventing (i) a tender offer for QuadraMed's Common Stock or other changes of control of QuadraMed that could be at a premium price, or (ii) changes in its management.

In addition, certain provisions of Delaware law could have the effect of delaying or preventing a change in control of QuadraMed, Section 203 of the Delaware General Corporation Law, for example, prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years from the date the person became an interested stockholder unless certain conditions are met.

The trading price of QuadraMed's Common Stock has been, and is expected to continue to be, extremely volatile.

The NASDAQ SmallCap Market on which QuadraMed is listed, and stock markets in general, have historically experienced extreme price and volume fluctuations that have affected companies unrelated to their individual operating performance. The trading price of QuadraMed's Common Stock has been and is likely to continue to be highly volatile due to such factors as:

- Variations in quarterly results of operations;
- Announcements of new products or acquisitions by QuadraMed's competitors;
- Governmental regulatory action;
- Developments or disputes with respect to proprietary rights;
- General trends in QuadraMed's industry and overall market conditions.

Movements in prices of equity securities may also affect the market price of QuadraMed's Common Stock in general.

Future sales of a substantial number of shares of QuadraMed's Common Stock could cause the price of the stock to decrease or fluctuate substantially.

Existing stockholders of QuadraMed hold a significant number of shares of Common Stock that may be sold in the future under Rule 144 of the Securities Act or through the exercise of registration rights. Sales of a substantial number of the aforementioned shares in the public markets or the prospect of such sales could adversely affect or cause substantial fluctuations in the market price of QuadraMed's Common Stock and convertible debentures and impair QuadraMed's ability to raise additional capital through the sale of its securities.

If QuadraMed is unable to achieve profitability, it may be forced to file for bankruptcy.

If QuadraMed's financial condition deteriorates and QuadraMed is unable to reduce its losses or obtain additional financing, QuadraMed may be forced to seek relief under Chapter 11 of the U.S. Bankruptcy Code. Chapter 11 permits a company to remain in control of its business, protected by a stay of all creditor action while the company attempts to negotiate and confirm a plan of reorganization with its creditors. If QuadraMed commenced a Chapter 11 case it would expect deterioration in its customer relationships, a reduction in orders, the loss of suppliers, and an erosion of employee morale. QuadraMed may be unsuccessful in its attempts to confirm a plan of reorganization with its creditors. Many Chapter 11 cases are unsuccessful, and virtually all involve substantial expense and damage to the business. If QuadraMed were unsuccessful in obtaining confirmation of a plan of reorganization, its assets could be liquidated and could be insufficient to pay all of its securityholders.

QuadraMed may lose some or all of its equity investments in early stage companies if such companies become bankrupt or insolvent or do not succeed in executing their business strategy appropriately.

QuadraMed has made equity investments and acquired minority interests in certain early stage companies. QuadraMed does not have the

ability to control the operations of these companies and these investments are subject to significant risks. There is no guarantee that QuadraMed will realize any return on such investments. QuadraMed could also lose some or all of its principal investment if these companies become bankrupt or insolvent or do not succeed in executing their business strategy.

Review of Financial Statements.

The financial information required in this Form 10-Q by Rule 10-01 of Regulation S-X has been subject to a review by Pisenti & Brinker LLP, the Company's independent certified public accountants, as described in their report dated August 2, 2001.

The unaudited condensed consolidated financial statements contained herein have been prepared on the same basis as QuadraMed's audited consolidated financial statements and, in the opinion of management, include all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the information for the periods presented. Management is continuing to review QuadraMed's financial statements and will obtain the assistance of outside resources as deemed necessary. Management's review is not expected to result in any material adjustments or charges; however, there can be no assurance that additional adjustments and/or charges will not be required.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None

ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS.

At the QuadraMed's annual meeting of stockholders held on June 15, 2001, the stockholders elected each of the nominees for Class II director on the Board of Directors. The vote totals were as follows:

Nominee	For	Withheld Authority
Michael J. King	19,814,193	1,787,165
Cornelius T. Ryan	20,791,255	810,103

The following directors' terms of office continue until the annual meeting indicated: Lawrence P. English (Class III term expires at the 2002 annual meeting); and Albert L. Green, F. Scott Gross and E. A. Roskovensky (Class I term expires at the 2003 annual meeting).

The following matters were also submitted to and approved by a vote of the stockholders with the results of the voting being as shown:

Proposal	For	Against	Abstain	Broker Non-Votes
Amend the Company's 1996 Stock Incentive Plan (i) to increase the number of shares authorized for issuance from 3,953,981 to 5,118,981, and (ii) to qualify the shares for purposes of Sections 162(m) and 422 of the Internal Revenue Code of 1985, as amended; and	18,132,908	2,588,174	880,276	--
Ratify the appointment of Pisenti & Brinker LLP as independent auditors for the fiscal year ending December 31, 2001.	21,176,168	417,014	8,176	--

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ITEM 5. OTHER INFORMATION.

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) EXHIBITS.

10.1 Grantor Trust Agreement by and between QuadraMed and Wachovia Bank, N.A., dated January 1, 2000.*

10.2 Grantor Trust Agreement Amendment by and between QuadraMed and Wachovia Bank, N.A., dated January 1, 2000.*

10.3 QuadraMed 1999 Supplemental Stock Option Plan, as adopted *

10.4 QuadraMed 1996 Stock Incentive Plan, as amended April 18, 2001.*

10.5 Amendment of Severance Agreement between James D. Durham and QuadraMed, dated July 31, 2001.*

15 Accountant's Letter.

27.1 Financial Data Schedule for the Quarter Ended 06/30/2001.

27.2 Financial Data Schedule for the Quarter Ended 06/30/2000.

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* Management contract, or compensatory plan or arrangement.

(b) REPORTS ON FORM 8-K.

On April 20, 2001, QuadraMed filed a Current Report on Form 8-K in which it reported in Item 5 the record and meeting dates for the Company's annual meeting of stockholders and the date after which stockholder proposals would be considered untimely.

On June 12, 2001, QuadraMed filed a Current Report on Form 8-K in

which it reported in Item 5 that it had issued a press release announcing projected revenues for 2001 and establishment of a stock repurchase program.

SIGNATURES

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

QUADRAMED CORPORATION (argin-top:0px;margin-bottom:0px">

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

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

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

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

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

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

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

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

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

Our success is dependent on our executive management.

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

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

Table of Contents

Economic disruptions and downturns may have negative repercussions for the Company.

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

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

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

Risks Related to our Partner Companies

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

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

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

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

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

Our partner companies business strategies are often highly dependent upon the successful launch and commercialization of an innovative information technology, medical device, healthcare diagnostic, etc. Despite all of our efforts to understand the research and development underlying the innovation or creation of such technologies, etc. before we deploy capital to a partner company, often times the performance of the technology, device, etc. never matches the expectations of us or the partner company. In those situations, it is likely that we will incur a partial or total loss of the capital which we deployed in such partner company.

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

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

Table of Contents

The technology and life sciences marketplaces are characterized by:

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

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

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

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

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

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

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

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

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

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

In addition, downturns in the economy as well as possible governmental responses to such downturns and/or to specific situations in the economy could affect the business prospects of certain of our partner companies, including, but not limited to, in the following ways: weaknesses in the financial services industries; reduced business and/or consumer spending; and/or systematic changes in the ways the healthcare system operates in the United States.

Some of our partner companies may be unable to protect their proprietary rights and may infringe on the proprietary rights of others.

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

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

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

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

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

Table of Contents

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

Our partner companies depend upon their ability to attract and retain senior management and key personnel, including trained technical and marketing personnel. Our partner companies also will need to continue to hire additional personnel as they expand. At present, none of our partner companies have employees represented by labor unions. Although our partner companies have not been the subject of a work stoppage, any future work stoppage could have a material adverse effect on their respective operations. A shortage in the availability of the requisite qualified personnel or work stoppage would limit the ability of our partner companies to grow, to increase sales of their existing products and services, and to launch new products and services.

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

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

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

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

Catastrophic events may disrupt our Partner Companies business.

Some of our partner companies are highly automated businesses and rely on their network infrastructure, various software applications and many internal technology systems and data networks for their customer support, development, sales and marketing and accounting and finance functions. Further, some of our partner companies provide services to their customers from data center facilities in multiple locations. Some of these data centers are operated by third-parties, and they have limited control over those facilities. A disruption or failure of these systems or data centers in the event of a natural disaster, telecommunications failure, power outage, cyber-attack, war, terrorist attack, or other catastrophic event could cause system interruptions, reputational harm, delays in product development, breaches of data security and loss of critical data. Such an event could also prevent them from fulfilling customer orders or maintaining certain service level requirements, particularly in respect of their SaaS offerings. While certain of our Partner Companies have developed certain disaster recovery plans and maintain backup systems to reduce the potentially adverse effect of such events, a catastrophic event that resulted in the destruction or disruption of any of their data centers or their critical business or information technology systems could severely affect their ability to conduct normal business operations and, as a result, their business, operating results and financial condition could be adversely affected.

We cannot provide assurance that our Partner Companies disaster recovery plans will address all of the issues they may encounter in the event of a disaster or other unanticipated issue, and their business interruption insurance may not adequately compensate them for losses that may occur from any of the foregoing. In the event that a natural disaster, terrorist attack, or other catastrophic event were to destroy any part of their facilities or

Table of Contents

interrupt their operations for any extended period of time, or if harsh weather or health conditions prevent them from delivering products in a timely manner, their business, financial condition and operating results could be adversely affected.

Risks Related to Our Initiatives to Expand Our Platform

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

Borrowers may default on their payments, which may have a negative effect on our financial performance.

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

Subordination

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

Debt Securities

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

Leverage

Our Penn Mezzanine participations are expected to include borrowers with significant levels of debt. Such situations are inherently more sensitive than others to declines in revenues and to increases in expenses and

Table of Contents

interest rates. The leveraged capital structure of such borrowers will increase the exposure of those borrowers to adverse economic factors such as downturns in the economy or deterioration in the condition of the borrower or its industry. Because these participations involve subordinated obligations, among the most junior in a borrower s capital structure, the inability of a borrower to service its debt obligations could result in a loss of our principal.

Minority Positions

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

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our corporate headquarters and administrative offices in Wayne, Pennsylvania contain approximately 20,000 square feet of office space in one building. We currently lease our corporate headquarters under a lease with approximately 2.5 years remaining.

Item 3. ***Legal Proceedings***

We, as well as our partner companies, are involved in various claims and legal actions arising in the ordinary course of business. While in the current opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our 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 our consolidated financial position and results of operations, or that of our partner companies. See Note 15 included in Item 8 Financial Statements and Supplementary Data in this Annual Report on Form 10-K for a discussion of ongoing claims and legal actions.

Item 4. ***Reserved***

ANNEX TO PART I EXECUTIVE OFFICERS OF THE REGISTRANT

Name	Age	Position	Executive Officer Since
Peter J. Boni	66	President, Chief Executive Officer and Director	2005
James A. Datin	49	Executive Vice President and Managing Director	2005
Brian J. Sisko	51	Senior Vice President and General Counsel	2007
Stephen T. Zarrilli	50	Senior Vice President and Chief Financial Officer	2008

Mr. Boni joined Safeguard as President and Chief Executive Officer and a member of the Board of Directors in August 2005. Prior to joining Safeguard, Mr. Boni was an Operating Partner for Advent International, a global private equity firm with $10 billion under management, from April 2004 to August 2005; Chairman and Chief Executive Officer of Surebridge, Inc., an applications outsourcer serving the mid-market, from March 2002 to April 2004; Managing Principal of Vested Interest LLC, a management consulting firm, from January 2001 to March 2002; and President and Chief Executive Officer of Prime Response, Inc., an enterprise applications software provider, from February 1999 to January 2001.

Mr. Datin joined Safeguard as Executive Vice President and Managing Director, Life Sciences Group in September 2005. Mr. Datin served as Chief Executive Officer of Touchpoint Solutions, Inc., a provider of software that enables customers to develop and deploy applications, content and media on multi-user interactive devices, from December 2004 to June 2005; Group President in 2004, and as Group President, International,

from 2001 to 2003, of Dendrite International, a provider of sales, marketing, clinical and compliance solutions

Table of Contents

and services to global pharmaceutical and other life sciences companies; and Group Director, Corporate Business Strategy and Planning at GlaxoSmithKline, from 1999 to 2001, where he also was a member of the company s Predictive Medicine Board of Directors that evaluated acquisitions and alliances. His prior experience also includes international assignments with and identifying strategic growth opportunities for E Merck and Baxter.

Mr. Sisko joined Safeguard as Senior Vice President and General Counsel in August 2007. Prior to joining Safeguard, Mr. Sisko served as Chief Legal Officer, Senior Vice President and General Counsel of Traffic.com (at the time, a public company), a former partner company of Safeguard that is a leading provider of accurate, real-time traffic information in the United States, from February 2006 until June 2007 (following its acquisition by NAVTEQ Corporation in March 2007); Chief Operating Officer from February 2005 to January 2006 of Halo Technology Holdings, Inc., a public holding company for enterprise software businesses (Halo Technology Holdings filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code in August 2007); ran B/T Business and Technology, an advisor and strategic management consultant to a variety of public and private companies, from January 2002 to February 2005; and was a Managing Director from April 2000 to January 2002, of Katalyst, LLC, a venture capital and consulting firm. Mr. Sisko also previously served as Senior Vice President Corporate Development and General Counsel of National Media Corporation, at the time a New York Stock Exchange-listed multi-media marketing company with operations in 70 countries, and as a partner in the corporate finance, mergers and acquisitions practice group of the Philadelphia-based law firm, Klehr, Harrison, Harvey, Branzburg & Ellers LLP.

Mr. Zarrilli joined Safeguard as Senior Vice President and Chief Financial Officer in June 2008. Prior to joining Safeguard, Mr. Zarrilli co-founded, in 2004, the Penn Valley Group, a middle-market management advisory and private equity firm, and served as a Managing Director until June 2008, and continues to serve as non-executive chairman of the Penn Valley Group. While at the Penn Valley Group, Mr. Zarrilli also served as Acting Senior Vice President, Acting Chief Administrative Officer and Acting Chief Financial Officer of Safeguard from December 2006 to June 2007. Mr. Zarrilli also served as the Chief Financial Officer, from 2001 to 2004, of Fiberlink Communications Corporation, a provider of remote access VPN solutions for large enterprises; as the Chief Executive Officer, from 2000 to 2001, of Concellera Software, Inc., a developer of content management software; as the Chief Executive Officer, from 1999 to 2000, and Chief Financial Officer, from 1994 to 1998, of US Interactive, Inc. (at the time a public company), a provider of Internet strategy consulting, marketing and technology services (US Interactive filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code in January 2001); and, previously, with Deloitte & Touche from 1983 to 1994. Mr. Zarrilli is a director and Chairman of the Audit Committee of NutriSystem, Inc.

PART II

Item 5. ***Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Safeguard s common stock is listed on the New York Stock Exchange (Symbol: SFE). The high and low sale prices reported within each quarter of 2011 and 2010 were as follows:

	High	Low
Fiscal year 2011:		
First quarter	$ 21.35	$ 16.25
Second quarter	20.99	17.11
Third quarter	19.08	13.02
Fourth quarter	18.26	13.88
Fiscal year 2010:		
First quarter	$ 13.34	$ 10.07
Second quarter	14.35	10.02
Third quarter	13.27	10.04
Fourth quarter	17.44	12.25

Table of Contents

The high and low sale prices reported in the first quarter of 2012 through February 29, 2012 were $18.20 and $15.42, respectively, and the last sale price reported on February 29, 2012, was $16.91. No cash dividends have been declared in any of the years presented, and Safeguard has no present intention to declare cash dividends.

As of February 29, 2012, there were approximately 23,000 beneficial holders of Safeguard s common stock.

The following graph compares the cumulative total return on $100 invested in our common stock for the period from December 31, 2006 through December 31, 2011 with the cumulative total return on $100 invested for the same period in the Russell 2000 Index and the Wilshire 4500 Index. In light of the diverse nature of Safeguard s business and based on our assessment of available published industry or line-of-business indices, we determined that no single industry or line-of-business index would provide a meaningful comparison to Safeguard. Further, we did not believe that we could readily identify an appropriate group of industry peer companies for this comparison. Accordingly, under SEC rules, we selected the Wilshire 4500 Index, a published market index in which the median market capitalization of the included companies is similar to our own. Safeguard s common stock is included as a component of the Russell 2000 and Wilshire 4500 indices.

Assumes reinvestment of dividends. We have not distributed cash dividends during this period.

Assumes an investment of $100 on December 31, 2006.

Table of Contents

Item 6. ***Selected Consolidated Financial Data***

The following table sets forth our selected consolidated financial data for the five-year period ended December 31, 2011. The selected consolidated financial data presented below should be read in conjunction with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8. Consolidated Financial Statements and Notes thereto included in this report. The historical results presented herein may not be indicative of future results. During the five-year period ended December 31, 2011, certain consolidated partner companies, or components thereof, were sold. These businesses are reflected in discontinued operations through their respective disposal dates: Acsis, Inc., Alliance Consulting Group Associates, Inc. and Laureate Pharma, Inc. (May, 2008), Pacific Title & Art Studio Inc. (March 2007) and Clarient s technology business (March 2007). The accounts of Clarient are included in continuing operations through May 14, 2009, the date of its deconsolidation.

	2011	2010	December 31, 2009 (In thousands)	2008	2007
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 83,187	$ 183,419	$ 67,347	$ 75,051	$ 96,201
Short-term marketable securities	158,098	42,411	39,066	14,701	590
Long-term marketable securities	16,287				
Restricted cash equivalents	12,265	16,774			
Cash held in escrow	6,433	6,434	6,910	6,934	22,686
Working capital of continuing operations	245,420	197,769	105,983	88,400	97,184
Total assets of continuing operations	406,636	336,545	282,099	232,402	258,075
Convertible senior debentures	45,694	75,919	78,225	86,000	129,000
Long-term debt, net of current portion				345	906
Other long-term liabilities	4,146	5,311	5,461	9,600	9,111
Total equity	348,280	246,431	190,507	104,710	155,831

Table of Contents

Consolidated Statements of Operations Data

	Year Ended December 31,				
	2011	2010	2009	2008	2007
	(In thousands except per share amounts)				
Revenue	$	$	$ 34,839	$ 73,736	$ 42,995
Operating Expenses:					
Cost of sales			13,811	33,007	26,914
Selling, general and administrative	21,168	20,847	37,214	60,744	50,783
Total operating expenses	21,168	20,847	51,025	93,751	77,697
Operating loss	(21,168)	(20,847)	(16,186)	(20,015)	(34,702)
Other income (loss), net	(6,145)	74,809	108,881	10,280	(5,077)
Interest income	1,424	718	480	3,097	7,520
Interest expense	(5,971)	(5,737)	(3,164)	(4,732)	(5,489)
Equity income (loss)	142,457	(22,334)	(23,227)	(34,697)	(15,178)
Net income (loss) from continuing operations before income taxes	110,597	26,609	66,784	(46,067)	(52,926)
Income tax benefit			14	24	687
Net income (loss) from continuing operations	110,597	26,609	66,798	(46,043)	(52,239)
Income (loss) from discontinued operations, net of tax			1,975	(9,620)	(17,282)
Net income (loss)	110,597	26,609	68,773	(55,663)	(69,521)
Net (income) loss attributable to noncontrolling interest			(1,163)	3,650	3,653
Net income (loss) attributable to Safeguard Scientifics, Inc.	$ 110,597	$ 26,609	$ 67,610	$ (52,013)	$ (65,868)
Basic Income (Loss) Per Share:					
Net income (loss) from continuing operations attributable to Safeguard Scientifics, Inc. common shareholders	$ 5.33	$ 1.30	$ 3.26	$ (2.10)	$ (2.28)
Net income (loss) from discontinued operations attributable to Safeguard Scientifics, Inc. common shareholders			0.07	(0.46)	(0.96)
Net income (loss) attributable to Safeguard Scientifics, Inc. common shareholders	$ 5.33	$ 1.30	$ 3.33	$ (2.56)	$ (3.24)
Shares used in computing basic income (loss) per share	20,764	20,535	20,308	20,326	20,328
Diluted Income (Loss) Per Share:					
Net income (loss) from continuing operations attributable to Safeguard Scientifics, Inc. common shareholders	$ 4.74	$ 1.24	$ 3.08	$ (2.10)	$ (2.28)
Net income (loss) from discontinued operations attributable to Safeguard Scientifics, Inc. common shareholders			0.06	(0.46)	(0.96)
Net income (loss) attributable to Safeguard Scientifics, Inc. common shareholders	$ 4.74	$ 1.24	$ 3.14	$ (2.56)	$ (3.24)

Shares used in computing diluted income (loss) per share	24,522	21,507	22,383	20,326	20,328

24

Table of Contents

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***
Cautionary Note concerning Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about Safeguard Scientifics, Inc. (Safeguard or we), the industries in which we operate and other matters, as well as management s beliefs and assumptions and other statements regarding matters that are not historical facts. These statements include, in particular, statements about our plans, strategies and prospects. For example, when we use words such as projects, expects, anticipates, intends, plans, believes, estimates, should, would, could, will, opportunity, potential or may, variations of such words or other words that convey uncertainty 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, risks associated with the development and commercialization of innovative technologies, etc, the ability to execute our strategy, the uncertainty of the future performance of our partner companies, acquisitions and dispositions of companies, the inability to manage growth, compliance with government regulation and legal liabilities, additional financing requirements, labor disputes and the effect of economic conditions in the business sectors in which our partner companies operate, all of which are discussed in Item 1A. Risk Factors. Many of these factors are beyond our ability to predict or control. In addition, as a result of these and other factors, our past financial performance should not be relied on as an indication of future performance. All forward-looking statements attributable to us, or to persons acting on our behalf, are expressly qualified in their entirety by this cautionary statement. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report might not occur.

Overview

Safeguard s charter is to build value in growing businesses by providing partner companies with capital and a range of strategic, operational and management resources. Safeguard may participate in expansion financings, corporate spin-outs, management buy-outs, recapitalizations, industry consolidations and early-stage financings. Our vision is to be the preferred catalyst to build great companies across diverse capital platforms.

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

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

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

Principles of Accounting for Ownership Interests in Partner Companies

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

Consolidation Method. We account for partner companies in which we maintain a controlling financial interest, generally those in which we directly or indirectly own more than 50% of the outstanding voting securities, using the consolidation method of accounting. Upon consolidation of our partner companies, we

reflect the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to the parent company as a non-controlling interest in the Consolidated Balance Sheet. The non-controlling interest is presented within equity, separately from the equity of the parent company. Losses attributable to the parent company and the non-controlling interest may exceed their interest in the subsidiary s equity. As a result, the non-controlling interest shall continue to be attributed its share of losses even if that attribution results in a deficit non-controlling interest balance as of each balance sheet date. Revenue, expenses, gains, losses, net income or loss are reported in the Consolidated Statements of Operations at the consolidated amounts, which include the amounts attributable to the parent company s common shareholders and the non-controlling interest. As of and for the year ended December 31, 2011, we did not hold a controlling interest in any of our partner companies.

Fair Value Method. We accounted for our holdings in Clarient, formerly one of our publicly traded partner companies, under the fair value method following its deconsolidation on May 14, 2009 and through the date of the sale of the remainder of our interests in Clarient in December 2010. Unrealized gains and losses on the mark-to-market of our holdings in Clarient and realized gains and losses on the sale of any of our holdings in Clarient were recognized in Other income (loss) in the Consolidated Statements of Operations. As of and for the year ended December 31, 2011, we did not apply the fair value method to account for our holdings in any of our partner companies.

Equity Method. We account for partner companies whose results are not consolidated, but over whom we exercise significant influence, using the equity method of accounting. We also account for our interests in some private equity funds under the equity method of accounting, based on our non-controlling general and limited partner interests. Under the equity method of accounting, our share of the income or loss of the company is reflected in Equity 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. The Company includes the carrying value of equity method partner companies in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

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

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

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

Critical Accounting Policies and Estimates

Accounting policies, methods and estimates are an integral part of the Consolidated Financial Statements prepared by management and are based upon management s current judgments. These judgments are normally based on knowledge and experience with regard to past and current events and assumptions about future events. Certain accounting policies, methods and estimates are particularly important because of their significance to the financial statements and because of the possibility that future events affecting them may differ from management s current judgments. While there are a number of accounting policies, methods and estimates affecting our financial statements as described in Note 1 to our Consolidated Financial Statements, areas that are particularly significant include the following:

- Impairment of ownership interests in and advances to partner companies and funds;

Accounting for participating interests in mezzanine loans receivable and related equity interests;

Income taxes;

Commitments and contingencies; and

Stock-based compensation.

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

On a periodic basis, but no less frequently than at the end of each quarter, we evaluate the carrying value of our equity and cost method partner companies and available-for-sale securities for possible impairment based on achievement of business plan objectives and milestones, the financial condition and prospects of the company, market conditions and other relevant factors. The business plan objectives and milestones we consider include, among others, those related to financial performance, such as achievement of planned financial results or completion of capital raising activities, and those that are not primarily financial in nature, such as hiring of key employees or the establishment of strategic relationships. We then determine whether there has been an other than temporary decline in the value of our ownership interest in the company. Impairment to be recognized is measured as the amount by which the carrying value of an asset exceeds its fair value. The adjusted carrying value of a partner company is not increased if circumstances suggest the value of the partner company has subsequently recovered.

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

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

Total impairment charges related to ownership interests in and advances to our equity and cost method partner companies and available-for-sale securities were as follows:

	Year Ended December 31,		
Accounting Method	**2011**	**2010**	**2009**
		(In millions)	
Equity	$ 7.1	$ 4.8	$ 4.1
Cost		2.1	10.1
Available-for-sale	7.5	1.1	
Total	$ 14.6	$ 8.0	$ 14.2

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

Table of Contents

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

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

Loan Participations Receivable

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

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

Equity Participations

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

Warrant Participations

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

Income Taxes

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

Commitments and Contingencies

From time to time, we are a defendant or plaintiff in various legal actions which arise in the normal course of business. Additionally, we have received distributions as both a general partner and a limited partner from private equity funds. In certain circumstances, we may be required to return a portion or all the distributions we received as a general partner of a fund for a further distribution to such fund s limited partners (clawback). We are also a guarantor of various third-party obligations and commitments and are subject to the possibility of various loss contingencies arising in the ordinary course of business (see Note 15). We are required to assess the likelihood of any adverse outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of provision required for these commitments and contingencies, if any, which would be charged to earnings, is made after careful analysis of each matter. The provision may change in the future due to new developments or changes in circumstances. Changes in the provision could increase or decrease our earnings in the period the changes are made.

Stock-Based Compensation

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

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

Results of Operations

In August 2011, we acquired a 36% ownership interest in Penn Mezzanine for $3.9 million. Penn Mezzanine is a mezzanine lender focused on lower middle-market, Mid-Atlantic companies. Our acquired interest in Penn Mezzanine is part of a broader effort to expand our capital deployment capabilities. Our purchase of the ownership interest enables us to participate in mezzanine loan and equity interests initiated by Penn Mezzanine. We expect to deploy up to an additional $26.1 million (including $9.7 million deployed in the fourth quarter of 2011 as described below) over a several year period in mezzanine opportunities alongside existing and future Penn Mezzanine funds. In the fourth quarter of 2011, we deployed an aggregate of $9.7 million for participation in certain mezzanine loans and equity interests initiated by Penn Mezzanine. Included in this funding was $8.1 million for participation in loans and $1.3 million for participations in equity interests acquired by Penn Mezzanine. We also participated in warrants to acquire common stock of certain borrowers. The fair value of the warrants at December 31, 2011 was determined to be $0.3 million. As a result of the capital deployed in 2011 and our plans to separately manage and evaluate the operating results of relationships such as Penn Mezzanine, we re-evaluated our reportable segments and we made the determination that Penn Mezzanine would be presented as a separate reportable segment.

Prior to deconsolidating Clarient on May 14, 2009, we presented Clarient as a separate segment. In December 2010 Clarient was acquired by GE Healthcare. From May 14, 2009 through the date of the sale of Clarient, we accounted for our retained interest in Clarient at fair value with unrealized gains and losses on the mark-to-market of our Clarient holdings and realized gains and losses on the sale of any of our Clarient holdings included in Other income (loss), net in the Consolidated Statements of Operations. During 2009, we re-evaluated

Table of Contents

our reportable operating segments and we made the determination that Clarient would no longer be reported as a separate segment since we did not separately evaluate Clarient s performance based upon its operating results. The mark-to-market activity associated with Clarient and the gain recorded upon its disposition is included in the Life Sciences segment. The results of operations of all of our partner companies are reported in our Life Sciences and Technology segments. The Life Sciences and Technology segments also include the gain or loss on the sale of respective partner companies, except for gains and losses included in discontinued operations.

Our management evaluates the Life Sciences and Technology segments performance based on equity income (loss) which is based on the number of partner companies accounted for under the equity method, our voting ownership percentage in these partner companies and the net results of operations of these partner companies and Other income or loss associated with cost method partner companies.

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

Other items include certain expenses, which are not identifiable to the operations of our operating business segments. Other items primarily consist of general and administrative expenses related to corporate operations, including employee compensation, insurance and professional fees, interest income, interest expense, other income (loss) and equity income (loss) related to private equity holdings. Other items also includes income taxes, which are reviewed by management independent of segment results.

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

	Year Ended December 31,		
	2011	2010	2009
		(In thousands)	
Life Sciences	$ 115,053	$ 70,658	$ 99,289
Technology	20,488	(10,508)	(12,742)
Penn Mezzanine	139		
Total segments	135,680	60,150	86,547
Other items:			
Corporate operations	(25,083)	(33,541)	(19,763)
Income tax benefit			14
Total other items	(25,083)	(33,541)	(19,749)
Net income from continuing operations	110,597	26,609	66,798
Income from discontinued operations, net of tax			1,975
Net income	110,597	26,609	68,773
Net income attributable to noncontrolling interest			(1,163)
Net income attributable to Safeguard Scientifics, Inc.	$ 110,597	$ 26,609	$ 67,610

There is intense competition in the markets in which our partner companies operate, and we expect competition to intensify in the future. Additionally, the markets in which these companies operate are characterized by rapidly changing technology, evolving industry standards, frequent introduction of new products and services, shifting distribution channels, evolving government regulation, frequently changing intellectual

property landscapes and changing customer demands. Their future success depends on each company s ability to execute its business plan and to adapt to its respective rapidly changing markets.

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

For purposes of the following listing of our Life Science and Technology partner companies, we omit from the listing companies which we have since sold our interest in or which we no longer consider to be active partner companies because we no longer actively influence the operations of such entities. We have not included partner companies where our relationship was consummated since December 31, 2011.

Life Sciences

The following active partner companies as of December 31, 2011 were included in Life Sciences:

	Safeguard Primary Ownership as of December 31,			Accounting
Partner Company	**2011**	**2010**	**2009**	**Method**
Alverix, Inc.	49.6%	49.6%	49.6%	Equity
Good Start Genetics, Inc.	26.3%	26.3%	NA	Equity
Medivo, Inc.	30.0%	NA	NA	Equity
NovaSom, Inc.	30.3%	NA	NA	Equity
NuPathe, Inc.	17.8%	18.1%	22.9%	Available -for-sale (1)
PixelOptics, Inc.	24.7%	NA	NA	Equity
Putney, Inc.	27.6%	NA	NA	Equity

(1) Our ownership interest in NuPathe is accounted for as available-for-sale securities following NuPathe s completion of an initial public offering in August 2010. We previously accounted for NuPathe under the equity method.

Results for the Life Sciences segment were as follows:

	Year Ended December 31,		
	2011	**2010**	**2009**
		(In thousands)	
Revenue	$	$	$ 34,839
Operating Expenses:			
Cost of sales			13,811
Selling, general and administrative			19,407
Total operating expenses			33,218
Operating income			1,621
Other income (loss), net	(7,236)	82,444	114,222
Interest income			4
Interest expense			(275)
Equity income (loss)	122,289	(11,786)	(16,283)

Net income from continuing operations before income taxes	$ 115,053	$ 70,658	$ 99,289

Table of Contents

Year ended December 31, 2011 versus year ended December 31, 2010

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

Equity income for Life Sciences increased $134.1 million for the year ended December 31, 2011 compared to the prior year. In 2011, our former equity method partner company Advanced BioHealing was acquired by Shire plc. We recognized a gain of $129.3 million in connection with the transaction. The remainder of the increase was attributable to smaller losses incurred for partner companies in the Life Sciences segment as well as a reduction of the number of companies in the Life Sciences segment.

Other Income (Loss), Net. Other income (loss), net decreased $89.7 million for the year ended December 31, 2011 compared to the prior year. The loss in 2011 primarily related to impairment charges of $5.9 million and $1.5 million on our holdings in NuPathe and Tengion Inc. (Tengion), respectively. The income in 2010 primarily related to a $43.0 million gain on the sale of Clarient to GE Healthcare Inc., a $20.3 million gain on the sale of Avid to Eli Lilly and Company and unrealized gains of $22.4 million on the mark-to-market of our holdings in Clarient prior to its sale, partially offset by $3.2 million in impairment charges associated with our holdings in Tengion, including amounts recognized both when Tengion was classified as a cost method partner company and when Tengion was classified as available-for-sale.

Year ended December 31, 2010 versus year ended December 31, 2009

Results of operations for the year ended December 31, 2009 include the results of operations of Clarient for the 134 days in the period from January 1, 2009 through May 14, 2009 that Clarient was consolidated. Upon the deconsolidation of Clarient on May 14, 2009, we no longer reported revenue, cost of sales, selling, general and administrative expenses, interest income and interest expense from Clarient s continuing operations in our results of operations. Prior to that date, for the periods presented, all of our Life Science segment revenue, cost of sales, selling, general and administrative expenses, interest income and interest expense from continuing operations were attributable to Clarient.

Other Income (Loss), Net. Other income (loss), net in 2010 related primarily to a $43.0 million gain on the sale of Clarient to GE Healthcare Inc., a $20.3 million gain on the sale of Avid to Eli Lilly and Company and unrealized gains of $22.4 million on the mark-to-market of our holdings in Clarient prior to its sale, partially offset by $3.2 million in impairment charges associated with our holdings in Tengion, including amounts recognized both when Tengion was classified as a cost method partner company and when Tengion was classified as available-for-sale.

On May 14, 2009, we deconsolidated our holdings in Clarient because we ceased to have a controlling financial interest in Clarient and recognized an unrealized gain on deconsolidation of $106.0 million as of that date. In addition, we recognized an unrealized gain of $19.5 million on the mark-to-market of our holdings in Clarient through December 31, 2009, which was offset by a $7.3 million realized loss on the sale of 18.4 million shares of common stock of Clarient in the third quarter of 2009 and an impairment charge of $3.9 million related to our holdings in Tengion.

Equity Income (Loss). Equity loss for Life Sciences decreased $4.5 million for the year ended December 31, 2010 compared to the prior year primarily due to an unrealized gain of $5.8 million on the decrease of our ownership interest in NuPathe upon completion of NuPathe s initial public offering, partially offset by a $1.8 million impairment charge related to our holdings in Molecular Biometrics, Inc.

Table of Contents

Technology

The following active partner companies as of December 31, 2011 were included in Technology:

Partner Company	Safeguard Primary Ownership as of December 31 2011	2010	2009	Accounting Method
AdvantEdge Healthcare Solutions, Inc.	40.2%	40.2%	39.7%	Equity
Beyond.com, Inc.	38.3%	38.3%	38.3%	Equity
Bridgevine, Inc.	22.8%	22.8%	23.6%	Equity
Crimson Informatics, Inc.	23.9%	NA	NA	Equity
Hoopla Software, Inc.	28.0%	NA	NA	Equity
MediaMath, Inc.	22.4%	17.3%	17.5%	Equity (1)
Swap.com, Inc.	45.6%	45.6%	29.3%	Equity
ThingWorx, Inc.	30.2%	NA	NA	Equity

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

Results for the Technology segment were as follows:

	Year Ended December 31, 2011	2010	2009
		(In thousands)	
Other income (loss), net	$ 24	$ 36	$ (5,846)
Equity income (loss)	20,464	(10,544)	(6,896)
Net income (loss) from continuing operations before income taxes	$ 20,488	$ (10,508)	$ (12,742)

Year ended December 31, 2011 versus year ended December 31, 2010

Equity Income (Loss). Equity income (loss) fluctuates with the number of Technology partner companies accounted for under the equity method, our voting ownership percentage in these partner companies and the net results of operations of these partner companies. We recognize our share of losses to the extent we have cost basis in the equity partner company or we have outstanding commitments or guarantees. Certain amounts recorded to reflect our share of the income or losses of our partner companies accounted for under the equity method are based on estimates and on unaudited results of operations of those partner companies and may require adjustments in the future when audits of these entities are made final. We report our share of the results of our equity method partner companies on a one quarter lag. Equity income for Technology increased $31.0 million for the year ended December 31, 2011 compared to the prior year. The increase was primarily related to the $35.4 million gain on the sale of Portico Systems, Inc. to McKesson in 2011, partially offset by an impairment charge of $5.7 million related to our holdings in Swap.com.

Year ended December 31, 2010 versus year ended December 31, 2009

Other Income (Loss), Net. Other income (loss), net decreased $5.9 million for the year ended December 31, 2010 compared to the prior year. The 2009 loss was entirely attributable to an impairment related to our holdings in GENBAND, a former partner company.

Equity Loss. Equity loss increased $3.6 million for the year ended December 31, 2010 compared to the prior year. The increase was due primarily to a $1.5 million impairment charge related to our holdings in SafeCentral, Inc. (SafeCentral , formerly Authentium, Inc.) as well as larger losses incurred at certain partner companies in 2010.

Table of Contents

Results for the Penn Mezzanine segment were as follows:

	00000000 Year Ended December 31, 2011 (In thousands)
Interest income	$ 210
Equity loss	(71)
Net income from continuing operations before income taxes	$ 139

Results of the Penn Mezzanine segment include interest, dividends and loan origination fees earned on the mezzanine loans in which we participate as well as equity income (loss) associated with our interests in the management company and general partner of Penn Mezzanine. As of December 31, 2011, we had a participation in six mezzanine investments initiated by Penn Mezzanine.

Corporate Operations

	Year Ended December 31,		
	2011	2010	2009
		(In thousands)	
General and administrative	$ (17,992)	$ (16,949)	$ (14,695)
Stock-based compensation	(3,052)	(3,777)	(2,982)
Depreciation	(124)	(121)	(130)
Interest income	1,214	718	476
Interest expense	(5,971)	(5,737)	(2,889)
Other income (loss), net	1,067	(7,671)	505
Equity loss	(225)	(4)	(48)
	$ (25,083)	$ (33,541)	$ (19,763)

General and Administrative. Our general and administrative expenses consist primarily of employee compensation, insurance, professional services such as legal, accounting and consulting, and travel-related costs.

General and administrative expenses increased $1.0 million for the year ended December 31, 2011 compared to the prior year primarily due to a $0.4 million increase in employee costs, an increase in severance expense of $0.5 million and an increase related to a legal settlement of $0.1 million, partially offset by a decrease in professional fees of $0.2 million. General and administrative expenses increased $2.3 million for the year ended December 31, 2010 compared to the prior year primarily due to a $1.8 million increase in employee costs and a $0.7 million increase in professional fees partially offset by a $0.4 million decrease in insurance costs.

Stock-Based Compensation. Stock-based compensation consists primarily of expense related to grants of stock options, restricted stock and deferred stock units to our employees.

Stock-based compensation decreased $0.7 million for the year ended December 31, 2011 compared to the prior year, primarily due to a $0.5 million decrease related to market-based awards and a $0.4 million decrease in service-based awards, partially offset by a $0.2 million increase related to performance-based awards. Stock-based compensation increased $0.8 million for the year ended December 31, 2010 compared to the prior year, primarily due to higher expense related to restricted stock units driven by the acceleration of expense recognized for grants to directors and executives who have reached retirement age and higher expense related to market-based awards due to acceleration of expense based on increases in our stock price.

Interest Income. Interest income includes all interest earned on cash and marketable security balances.

Interest income increased $0.5 million for the year ended December 31, 2011 compared to the prior year. The increase was primarily due to $0.3 million in interest income earned on a mezzanine loan provided to Portico Systems Inc, as well as higher average cash balances in 2011 when compared to the prior year. Interest income

34

Table of Contents

increased $0.2 million for the year ended December 31, 2010 compared to the prior year. The increase was due to higher average cash balances in the second half of 2010.

Interest Expense. Interest expense is primarily related to our 2024 and 2014 Debentures. As discussed below under Liquidity and Capital Resources, we exchanged a portion of our 2024 Debentures effective March 26, 2010. The increase in interest expense of $0.2 million for the year ended December 31, 2011 compared to the prior year is due to a full year of the higher coupon rate of 10.125% payable on our 2014 Debentures as compared to a 2.625% coupon rate on the 2024 Debentures and accretion of the discount and amortization of debt issuance costs in the amount of $0.8 million associated with our 2014 Debentures. The increase of $2.8 million for the year ended December 31, 2010 compared to the prior year is related to the higher coupon rate of 10.125% payable on our 2014 Debentures as compared to a 2.625% coupon rate on the 2024 Debentures and accretion of the discount and amortization of debt issuance costs in the amount of $0.5 million associated with our 2014 Debentures. We expect interest expense to decrease in 2012 due to the repurchase of $30.8 million of the 2024 Debentures in 2011.

Other Income (Loss), net. Other income (loss), net for the year ended December 31, 2011 included the release of $1.0 million from accrued expenses due to the expiration of a contingency period associated with a clawback liability in one of our private equity funds, in accordance with the terms of the respective partnership agreement. Other income (loss), net for the year ended December, 31 2010 included an $8.5 million loss on exchange of $46.9 million in face value of our convertible senior debentures, partially offset by a $0.3 million gain on sales of legacy assets and $0.3 million related to a change in our estimated net clawback liability attributable to a private equity fund.

Income Tax (Expense) Benefit

Our consolidated net income tax (expense) benefit for 2011, 2010 and 2009 was $0.0 million in each year. We have recorded a valuation allowance to reduce our net deferred tax asset to an amount that is more likely than not to be realized in future years. Accordingly, the income tax expense that would have been recognized in 2011, 2010 and 2009 was offset by changes in the valuation allowance.

Discontinued Operations

The following are reported in discontinued operations for all periods through their respective sale date.

In March 2007, we sold Pacific Title & Art Studio for net cash proceeds of approximately $21.9 million, including $2.3 million held in escrow. In the first quarter of 2010, we received the final $0.5 million in cash from the escrow account. This amount was recorded as income from discontinued operations in 2009.

In March 2007, Clarient sold its technology business and related intellectual property for an aggregate purchase price of $12.5 million. The $12.5 million consisted of $11.0 million in cash and an additional $1.5 million in contingent consideration, subject to the satisfaction of certain post-closing conditions through March 2009. Clarient received the contingent consideration and recorded the $1.5 million in income from discontinued operations in 2009.

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 the issuance of debt as sources of liquidity and may do so in the future. Our ability to generate liquidity from sales of partner companies, sales of marketable securities and from equity and debt issuances has been adversely affected from time to time by adverse circumstances in the U.S. capital markets and other factors.

As of December 31, 2011, we had $83.2 million of cash and cash equivalents and $174.4 million of marketable securities for a total of $257.6 million. In addition, $6.4 million of cash was held in escrow, including accrued interest, related to the Bundle Transaction and $12.3 million was held in a restricted escrow account to service interest on the 2014 Debentures, as discussed below.

Table of Contents

In February 2012, we deployed $10.0 million into Spongecell Inc. (Spongecell). Spongecell is an advertising technology company that turns standard banner ads into dynamic ads with rich media. Our primary ownership interest in Spongecell is approximately 23.1% and the partner company will be accounted for under the equity method.

In February 2012, we deployed $2.2 million into Lumesis Inc. (Lumesis). Lumesis is a financial technology company that is dedicated to delivering timely data and robust analytical tools for the fixed income marketplace. Our primary ownership interest in Lumesis is approximately 31.6% and the partner company will be accounted for under the equity method.

In August 2011, we acquired a 36% ownership interest in Penn Mezzanine, a mezzanine lender focused on lower middle-market, Mid-Atlantic companies, for $3.9 million. Our purchase of the ownership interest enables us to participate in mezzanine loans and related equity interests initiated by Penn Mezzanine. We expect to deploy up to an additional $26.1 million (including $9.7 million deployed in the fourth quarter of 2011 as described below) in Penn Mezzanine over a several year period in mezzanine opportunities alongside existing and future Penn Mezzanine funds. In the fourth quarter of 2011, we deployed an aggregate of $9.7 million for participations in certain mezzanine loans and equity interests initiated by Penn Mezzanine.

Portico Systems was acquired by McKesson in July 2011 and we received cash proceeds in exchange for our equity interests of approximately $32.8 million, excluding $3.4 million which will be held in escrow for a period of one year. In addition, depending on the achievement of certain milestones, we may receive an additional $1.9 million after a period of one year. Portico also repaid its mezzanine loan facility with us in the principal amount of $5.0 million in connection with the transaction.

In the June 2011, Advanced BioHealing was acquired by Shire plc, resulting in net proceeds of $138.2 million. An additional $7.6 million was placed in escrow until March 2012.

In December 2010, Clarient was acquired by GE Healthcare, a unit of GE, via a public tender offer for all outstanding common and preferred shares of Clarient, followed by a second step merger of Clarient with an indirect subsidiary of GE. In connection with the transactions, we received gross proceeds of $153.4 million and paid retention bonuses to Clarient management in the amount of $6.9 million, resulting in net proceeds of $146.5 million. We held a 27.5% primary ownership stake in Clarient at the time of the sale.

In December 2010, Avid was acquired by Eli Lily and Company resulting in net proceeds to us of $32.3 million. We held a 13% primary ownership interest in Avid at the time of the sale. Depending on the achievement of certain difficult milestones, we could receive additional proceeds of up to $58.0 million, as well as an additional $3.4 million currently being held in escrow until the second quarter of 2012.

In December 2010, we received cash proceeds of $2.6 million on the sale of Quinnova Pharmaceuticals, Inc. Depending on certain milestones, we could receive additional proceeds of $1.9 million.

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

In 2004, we issued an aggregate of $150 million in face value of convertible senior debentures with a stated maturity date of March 15, 2024 (the 2024 Debentures). We had $0.4 million of the 2024 Debentures outstanding at December 31, 2011. On March 21, 2011, we repurchased $30.8 million of the 2024 Debentures as required by the Debenture holders. Interest on the 2024 Debentures is payable semi-annually. At the debentures holders option, the 2024 Debentures are convertible into our common stock through March 14, 2024, subject to certain conditions. The adjusted conversion rate of the debentures is $43.3044 of principal amount per share. The closing price of our common stock at December 31, 2011 was $15.79. The remaining 2024 Debentures holders have the right to require us to repurchase the 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their face amount, plus accrued and unpaid interest. In limited circumstances, we have the right to redeem all or some of the 2024 Debentures.

Table of Contents

In March 2010, we issued $46.9 million in face value of our 10.125% senior convertible debentures, due 2014 (the 2014 Debentures) in an exchange transaction for the same face amount of our 2024 Debentures. Interest on the 2014 Debentures is payable semi-annually. As required by the terms of the 2014 Debentures, at issuance we placed approximately $19.0 million in a restricted escrow account to service interest associated with the 2014 Debentures through their maturity. At the debentures holders option, the 2014 Debentures are convertible into our common stock prior to March 15, 2013 subject to certain conditions, and at anytime after March 15, 2013. The conversion rate of the 2014 Debentures is $16.50 of principal amount per share. The closing price of our common stock at December 31, 2011 was $15.79. The 2014 Debentures holders have the right to require repurchase of the 2014 Debentures upon certain events, including sale of all or substantially all of our common stock or assets, liquidation, dissolution, a change in control or the delisting of our common stock from the New York Stock Exchange if we were unable to obtain a listing for our common stock on another national or regional securities exchange. Subject to certain conditions, we may mandatorily convert all or some of the 2014 Debentures at any time after March 15, 2012. If we elect to mandatorily convert any of the 2014 Debentures, we will be required to pay any interest that would have accrued and become payable on the debentures through their maturity. Upon a conversion of the 2014 Debentures, we have the right to settle the conversion in stock, cash or a combination thereof.

Because the 2014 Debentures may be settled in cash or partially in cash upon conversion, we have separately accounted for the liability and equity components of the 2014 Debentures. The carrying amount of the liability component was determined at the exchange date by measuring the fair value of a similar liability that does not have an associated equity component. The carrying amount of the equity component represented by the embedded conversion option was determined by deducting the fair value of the liability component from the carrying value of the 2014 Debentures as a whole. The carrying value of the 2014 Debentures as a whole was equal to their fair value at the exchange date. We are amortizing the excess of the face value of the 2014 Debentures over their carrying value to interest expense over their term. At December 31, 2011, the fair value of the $46.9 million outstanding 2014 Debentures was approximately $61.0 million based on quoted market prices as of such date.

In November 2011, our Board of Directors authorized us, from time to time and depending on market conditions, to repurchase shares of our outstanding common stock, with up to an aggregate value of $10.0 million, exclusive of fees and commissions.

We are party to a loan agreement which provides us with a revolving credit facility in the maximum aggregate amount of $50 million in the form of borrowings, guarantees and issuances of letters of credit (subject to a $20 million sublimit). Actual availability under the credit facility is based on the amount of cash maintained at the bank as well as the value of our public and private partner company interests. This credit facility bears interest at the prime rate for outstanding borrowings, subject to an increase in certain circumstances. Other than for limited exceptions, we are required to maintain all of our depository and operating accounts and the lesser of $80 million or 75% of our investment and securities accounts at the bank. The credit facility, as amended December 31, 2010, matures on December 31, 2012. Under the credit facility, we provided a $6.3 million letter of credit expiring on March 19, 2019 to the landlord of CompuCom Systems, Inc. s Dallas headquarters which has been required in connection with our sale of CompuCom Systems in 2004. Availability under our revolving credit facility at December 31, 2011 was $43.7 million.

At December 31, 2011, we had committed capital of approximately $0.2 million to various private equity funds. These commitments are expected to be funded in the next 12 months.

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

In May 2001, we entered into a $26.5 million loan agreement with Warren V. Musser, our former Chairman and Chief Executive Officer. Since 2001 and through December 31, 2011, we have received a total of $16.9

Table of Contents

million in payments on the loan. We received cash from the sale of collateral in early 2011 in the amount of $0.1 million and no payments in 2010. The carrying value of the loan at December 31, 2011 was zero. In December 2011, the loan documents were amended to take into account accumulated unpaid interest and to make certain other changes related to collateral, maturity dates and other terms.

We have received distributions as both a general partner and a limited partner from certain private equity funds. Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner of a fund for further distribution to such fund s limited partners (clawback). The maximum clawback we could be required to return related to our general partner interest is $1.3 million, of which $1.0 million was reflected in accrued expenses and other current liabilities and $0.3 million was reflected in Other long-term liabilities on the Consolidated Balance Sheet at December 31, 2011. In the fourth quarter of 2011, we released $1.0 million from accrued expenses due to the expiration of a contingency period in accordance with the terms of the respective partnership agreement.

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

For the reasons we presented above, we believe our cash and cash equivalents at December 31, 2011, availability under our revolving credit facility and other internal sources of cash flow will be sufficient to fund our cash requirements for at least the next 12 months, including debt repayments, commitments to our existing companies and funds, possible additional funding of existing partner companies and our general corporate requirements. Our acquisition of new partner company interests is always contingent upon our availability of cash to fund such deployments, and our timing of monetization events directly affects our availability of cash.

Consolidated Working Capital From Continuing Operations

Consolidated working capital from continuing operations increased to $245.4 at December 31, 2011 compared to $197.8 at December 31, 2010. The increase was primarily due to the sale of our interests in Advanced BioHealing and Portico in 2011 resulting in net sale proceeds to Safeguard of $138.2 and $32.8 million, respectively.

Analysis of Consolidated Cash Flows

Cash flow activity was as follows:

	Year Ended December 31,		
	2011	**2010**	**2009**
		(In thousands)	
Net cash used in operating activities	$ (17,727)	$ (16,019)	$ (19,170)
Net cash provided by (used in) investing activities	(52,575)	131,856	47
Net cash provided by (used in) financing activities	(29,930)	235	11,419
	$ (100,232)	$ 116,072	$ (7,704)

Cash Used In Operating Activities

Year ended December 31, 2011 versus year ended December 31, 2010. Net cash used in operating activities increased $1.7 million in 2011 as compared to the prior year. The change primarily related to a $1.4 million increase in cash used for payments under our management incentive plan, an increase in severance payments of $0.5 million, higher employee compensation costs of $0.4 million and an increase in insurance costs of $0.1 million, partially offset by a $1.0 million decrease in cash used for the payment of interest on the 2024 Debentures.

Table of Contents

Year ended December 31, 2010 versus year ended December 31, 2009. Net cash used in operating activities decreased $3.2 million in 2010 as compared to the prior year. The change was primarily related to cash used in operating activities of Clarient in the prior year period prior to its deconsolidation of $4.5 million, partially offset by cash used for interest payments on the 2024 and 2014 Debentures.

Cash Provided by (Used In) Investing Activities

Year ended December 31, 2011 versus year ended December 31, 2010. Net cash provided by (used in) investing activities decreased $184.4 million as compared to the prior year. The decrease was primarily related to a $64.9 million increase in cash paid to acquire ownership interests in companies and funds, a $128.7 million net increase in cash paid to acquire marketable securities and a $12.5 million decrease in proceeds from sales of and distributions from companies and funds, partially offset by a $3.0 million increase in repayments of advances to partner companies, $0.5 million in cash received for origination fees on mezzanine loans and $18.9 million of cash transferred to escrow to service interest payments on the 2014 Debentures in the prior year.

Year ended December 31, 2010 versus year ended December 31, 2009. Net cash provided by investing activities increased $131.8 million in 2010 as compared to the prior year. The increase was primarily related to a $122.5 million increase in proceeds from sales of and distributions from companies and funds, a $21.0 million net decrease in cash paid to acquire marketable securities, a $15.5 million decrease in cash paid to acquire ownership interests in partner companies and funds, a $2.0 million decrease in restricted cash, a $2.1 million decrease in capital expenditures and a $2.7 million decrease in cash related to the deconsolidation of subsidiary cash in the prior year period, partially offset by $18.9 million of cash transferred to escrow to service interest payments on the 2014 Debentures, a $10.4 million increase in advances to partner companies and a $3.7 million decrease in repayment of advances to partner companies.

Cash Provided by (Used In) Financing Activities

Year ended December 31, 2011 versus year ended December 31, 2010. Net cash provided by (used in) financing activities decreased $30.2 million as compared to the prior year. The change primarily related to the repurchase of $30.8 million of the 2024 Debentures during 2011.

Year ended December 31, 2010 versus year ended December 31, 2009. Net cash provided by financing activities decreased by $11.2 million in 2010 as compared to the prior year. The decrease was primarily related to a $28.1 million decrease in proceeds received from the issuance of subsidiary common stock, partially offset by a $9.5 million reduction in payments on revolving credit facilities, a $7.3 million reduction in the repurchase of convertible senior debentures and a $0.8 million increase related to the issuance of our common stock associated with stock option exercises.

Contractual Cash Obligations and Other Commercial Commitments

The following table summarizes our contractual obligations and other commercial commitments as of December 31, 2011, by period due or expiration of the commitment.

	Payments Due by Period				
	Total	**2012**	**2013 and 2014**	**2015 and 2016**	**Due after 2016**
			(In millions)		
Contractual Cash Obligations:					
Convertible senior debentures(a)	$ 47.3	$	$ 47.3	$	$
Operating leases	1.6	0.5	1.0	0.1	
Funding commitments(b)	0.2	0.2			
Potential clawback liabilities(c)	1.3	1.0	0.3		
Other long-term obligations(d)	3.8	0.8	1.5	1.5	
Total Contractual Cash Obligations	$ 54.2	$ 2.5	$ 50.1	$ 1.6	$

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

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

(b) These represent funding commitments to private equity funds which have been included in the respective years based on estimated timing of capital calls provided to us by the funds management.

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

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

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

We have agreements with certain employees that provide for severance payments to the employee in the event the employee is terminated without cause or if the employee terminates his employment for good reason. The maximum aggregate cash exposure under the agreements was approximately $8 million at December 31, 2011.

We remain guarantor of Laureate Pharma s Princeton, New Jersey facility lease (the Laureate Lease Guaranty). Such guarantee may extend through the lease expiration in 2016 under certain circumstances. However, we are entitled to indemnification in connection with the continuation of such guaranty. As of December 31, 2011, scheduled lease payments to be made by Laureate Pharma over the remaining lease term equaled $6.0 million.

As of December 31, 2011, Safeguard had federal net operating loss carryforwards totaling approximately $159.2 million. The net operating loss carryforwards expire in various amounts from 2021 to 2030.

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

Recent Accounting Pronouncements

We will adopt the following new accounting standards as of January 1, 2012, the first day of its 2012 fiscal year:

Amendment to Fair Value Measurement: In May 2011, the Financial Accounting Standards Board (FASB) revised the fair value measurement and disclosure requirements so that the requirements under U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) are the same. The guidance clarifies the FASB s intent about the application of existing fair value measurements and requires enhanced disclosures, most significantly related to unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy. The guidance is effective

Table of Contents

prospectively during interim and annual periods beginning after December 15, 2011. The adoption of the amendment to fair value measurement is not expected to have a significant impact on our Consolidated Financial Statements.

Amendment to Comprehensive Income: In June 2011, the FASB amended guidance relating to the presentation requirements of comprehensive income within an entity s financial statements. Under the guidance, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in a single continuous statement or in two separate but consecutive statements. The amended guidance eliminates the previously available option of presenting the components of other comprehensive income as part of the statement of changes in equity. The amendment is effective for fiscal years beginning after December 15, 2011 and will be applied retrospectively.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to equity price risks on the marketable portion of our ownership interests in our partner companies and other assets. At December 31, 2011, these interests include our equity positions in NuPathe and Tengion, both publicly-traded entities, which have experienced significant volatility in their stock prices. Historically, we have not attempted to reduce or eliminate our market exposure related to these types of interests. Based on closing market prices at December 31, 2011, the aggregate fair market value of our holdings in NuPathe and Tengion was $5.2 million. A 20% decrease in NuPathe and Tengion s stock price would result in an approximate $1.0 million decrease in the aggregate fair value of our holdings in these companies.

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

Liabilities	**2012**	**2013**	**2014**	**After 2014**	**Fair Value at December 31, 2011**
2024 Debentures due by year (in millions)	$	$	$ 0.4	$	$ 0.4
Fixed interest rate	2.625%	2.625%	2.625%	2.625%	N/A
Interest expense (in millions)	$	$	$	$	N/A
2014 Debentures due by year (in millions)	$	$	$ 46.9	$	$ 61.0
Fixed interest rate	10.125%	10.125%	10.125%	10.125%	N/A
Interest expense (in millions)	$ 4.8	$ 4.8	$ 1.0	$	N/A

We have historically had very low exposure to changes in foreign currency exchange rates, and as such, have not used derivative financial instruments to manage foreign currency fluctuation risk.

We maintain cash and cash equivalents and marketable securities with various financial institutions. The financial institutions are highly rated.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data***

The following Consolidated Financial Statements, and the related Notes thereto, of Safeguard Scientifics, Inc. and the Reports of Independent Registered Public Accounting Firm are filed as a part of this Form 10-K.

	Page
Report of Independent Registered Public Accounting Firm	43
Report of Independent Registered Public Accounting Firm	44
Consolidated Balance Sheets as of December 31, 2011 and 2010	45
Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009	46
Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2011, 2010 and 2009	47
Consolidated Statements of Changes in Equity for the years ended December 31, 2011, 2010 and 2009	48
Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009	49
Notes to Consolidated Financial Statements	50

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Safeguard Scientifics, Inc.:

We have audited Safeguard Scientifics, Inc. s (the Company) internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Safeguard Scientifics, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting (Item 9A.(b)). Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Safeguard Scientifics, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Safeguard Scientifics, Inc. as of December 31, 2011 and 2010, and the related consolidated statements of operations, comprehensive income (loss), changes in equity and cash flows for each of the years in the three-year period ended December 31, 2011, and our report dated March 2, 2012 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Philadelphia, Pennsylvania

March 2, 2012

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Safeguard Scientifics, Inc.:

We have audited the accompanying consolidated balance sheets of Safeguard Scientifics, Inc. (the Company) and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, comprehensive income (loss), changes in equity and cash flows for each of the years in the three-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Safeguard Scientifics, Inc. as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Safeguard Scientific, Inc. s internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 2, 2012 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

Philadelphia, Pennsylvania

March 2, 2012

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED BALANCE SHEETS

	As of December 31, 2011	2010 (As Revised, See Note 20)
	(In thousands except per share data)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 83,187	$ 183,419
Cash held in escrow	6,433	6,434
Marketable securities	158,098	42,411
Restricted cash equivalents	5,137	4,893
Prepaid expenses and other current assets	1,081	785
Total current assets	253,936	237,942
Property and equipment, net	228	295
Ownership interests in and advances to partner companies and funds	114,169	60,256
Loan participations receivable	7,587	
Available-for-sale securities	5,184	25,447
Long-term marketable securities	16,287	
Long-term restricted cash equivalents	7,128	11,881
Other	2,117	724
Total Assets	$ 406,636	$ 336,545
LIABILITIES AND EQUITY		
Current Liabilities:		
Convertible senior debentures current	$	$ 31,289
Accounts payable	243	493
Accrued compensation and benefits	4,583	4,168
Accrued expenses and other current liabilities	3,690	4,223
Total current liabilities	8,516	40,173
Other long-term liabilities	4,146	5,311
Convertible senior debentures non-current	45,694	44,630
Commitments and contingencies		
Equity:		
Preferred stock, $0.10 par value; 1,000 shares authorized		
Common stock, $0.10 par value; 83,333 shares authorized; 20,752 and 20,630 shares issued and outstanding in 2011 and 2010, respectively	2,075	2,063
Additional paid-in capital	810,956	806,859
Accumulated deficit	(464,710)	(575,307)
Accumulated other comprehensive income (loss)	(41)	12,816
Total equity	348,280	246,431
Total Liabilities and Equity	$ 406,636	$ 336,545

See Notes to Consolidated Financial Statements.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2011	2010 (As Revised, See Note 20)	2009
	(In thousands except per share data)		
Revenue	$	$	$ 34,839
Operating Expenses:			
Cost of sales			13,811
Selling, general and administrative	21,168	20,847	37,214
Total operating expenses	21,168	20,847	51,025
Operating loss	(21,168)	(20,847)	(16,186)
Other income (loss), net	(6,145)	74,809	108,881
Interest income	1,424	718	480
Interest expense	(5,971)	(5,737)	(3,164)
Equity income (loss)	142,457	(22,334)	(23,227)
Net income from continuing operations before income taxes	110,597	26,609	66,784
Income tax benefit			14
Net income from continuing operations	110,597	26,609	66,798
Income from discontinued operations, net of tax			1,975
Net income	110,597	26,609	68,773
Net income attributable to noncontrolling interest			(1,163)
Net income attributable to Safeguard Scientifics, Inc.	$ 110,597	$ 26,609	$ 67,610
Basic Income Per Share:			
Net income from continuing operations attributable to Safeguard Scientifics, Inc. common shareholders	$ 5.33	$ 1.30	$ 3.26
Net income from discontinued operations attributable to Safeguard Scientifics, Inc. common shareholders			0.07
Net income attributable to Safeguard Scientifics, Inc. common shareholders	$ 5.33	$ 1.30	$ 3.33
Diluted Income Per Share:			
Net income from continuing operations attributable to Safeguard Scientifics, Inc. common shareholders	$ 4.74	$ 1.24	$ 3.08
Net income from discontinued operations attributable to Safeguard Scientifics, Inc. common shareholders			0.06
Net income attributable to Safeguard Scientifics, Inc. common shareholders	$ 4.74	$ 1.24	$ 3.14
Average shares used in computing income per share:			
Basic	20,764	20,535	20,308

Diluted	24,522	21,507	22,383
Amounts attributable to Safeguard Scientifics, Inc. common shareholders:			
Net income from continuing operations	$ 110,597	$ 26,609	$ 66,240
Net income from discontinued operations			1,370
Net income attributable to Safeguard Scientifics, Inc.	$ 110,597	$ 26,609	$ 67,610

See Notes to Consolidated Financial Statements.

46

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Year Ended December 31,		
	2011	2010 (As Revised, See Note 20)	2009
		(In thousands)	
Net income	$ 110,597	$ 26,609	$ 68,773
Other comprehensive income (loss), before taxes:			
Unrealized net gain (loss) on available-for-sale securities	(20,308)	11,708	
Reclassification adjustment for other than temporary impairment of available-for-sale securities included in net income (loss)	7,451	1,108	
Foreign currency translation adjustments			(2)
Reclassification adjustment for deconsolidation of subsidiary			31
Total comprehensive income	97,740	39,425	68,802
Comprehensive (income) loss attributable to the noncontrolling interest			(1,163)
Comprehensive income attributable to Safeguard Scientifics, Inc.	$ 97,740	$ 39,425	$ 67,639

See Notes to Consolidated Financial Statements.

47

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Total	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Common Stock		Additional Paid-In Capital	Treasury Stock		Noncontrolling Interest
				Shares	Amount		Shares	Amount	
				(In thousands)					
Balance December 31, 2008	$ 104,710	$ (669,526)	$ (29)	20,265	$ 2,026	$ 773,456	155	$ (1,217)	
Net income	68,773	67,610							1,163
Stock options exercised, net	270			34	3	267	(1)		
Issuance of restricted stock, net	225			121	13	(1,038)	(157)	1,250	
Stock-based compensation expense	3,825					3,825			
Repurchase of common stock	(44)						4	(44)	
Note receivable repayment in Company common stock						476	43	(476)	
Impact of subsidiary equity transactions	12,750		31			13,882			(1,163)
Other comprehensive loss	(2)		(2)						
Balance December 31, 2009	190,507	(601,916)		20,420	2,042	790,868	44	(487)	
Net income (As revised, See Note 20)	26,609	26,609							
Stock options exercised, net	1,107			102	10	923	(18)	174	
Issuance of restricted stock, net	142			84	9	133	3		
Stock-based compensation expense	3,777					3,777			
Equity component of convertible senior debentures issued, net of issuance costs	10,842					10,842			
Stock awards	631			24	2	316	(29)	313	
Other comprehensive income	12,816		12,816						
Balance December 31, 2010	246,431	(575,307)	12,816	20,630	2,063	806,859			
Net income	110,597	110,597							
Stock options exercised, net	918			95	10	908	5		
Issuance of restricted stock, net	139			27	2	137	(5)		
Stock-based compensation expense	3,052					3,052			
Other comprehensive loss	(12,857)		(12,857)						
Balance December 31, 2011	$ 348,280	$ (464,710)	$ (41)	20,752	$ 2,075	$ 810,956		$	$

See Notes to Consolidated Financial Statements.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2011	2010	2009
		(In thousands)	
Cash Flows from Operating Activities:			
Net income	$ 110,597	$ 26,609	$ 68,773
Adjustments to reconcile to net cash used in operating activities:			
(Income) loss from discontinued operations			(1,975)
Depreciation	124	121	1,425
Amortization of debt discount	623	426	
Equity (income) loss	(142,457)	22,334	23,227
Other (income) loss, net	6,145	(74,809)	(108,881)
Bad debt expense			3,936
Stock-based compensation expense	3,052	3,777	3,825
Changes in assets and liabilities, net of effect of acquisitions and dispositions:			
Accounts receivable, net	(429)	(195)	(11,467)
Accounts payable, accrued expenses, deferred revenue and other	4,618	5,718	1,967
Net cash used in operating activities	(17,727)	(16,019)	(19,170)
Cash Flows from Investing Activities:			
Proceeds from sales of and distributions from companies and funds	171,268	183,813	61,302
Advances and loans to companies	(12,127)	(11,710)	(1,350)
Origination fees on mezzanine loans	537		
Repayment of advances to partner companies	5,000	2,009	5,679
Acquisitions of ownership interests in companies and funds, net of cash acquired	(85,329)	(20,418)	(35,939)
Increase in marketable securities	(240,367)	(65,201)	(73,187)
Decrease in marketable securities	108,393	61,856	48,822
Increase in restricted cash, net			(1,956)
Investment in restricted cash equivalents for interest on convertible senior debentures		(18,864)	
Capital expenditures	(58)	(106)	(2,157)
Deconsolidation of subsidary cash			(2,667)
Proceeds from sale of discontinued operations, net	1	477	1,500
Other, net	107		
Net cash provided by (used in) investing activities	(52,575)	131,856	47
Cash Flows from Financing Activities:			
Repurchase of convertible senior debentures	(30,848)		(7,271)
Costs on exchange of convertible senior debentures		(872)	
Borrowings on revolving credit facilities			23,726
Repayments on revolving credit facilities			(33,237)
Repayments on term debt			(107)
Issuance of Company common stock, net	918	1,107	270
Issuance of subsidiary equity, net			28,082
Repurchase of Company common stock			(44)
Net cash provided by (used in) financing activities	(29,930)	235	11,419
Net Increase (Decrease) in Cash and Cash Equivalents	(100,232)	116,072	(7,704)
Cash and Cash Equivalents at beginning of period	183,419	67,347	75,051

Cash and Cash Equivalents at end of period	$ 83,187	$ 183,419	$ 67,347

See Notes to Consolidated Financial Statements.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Significant Accounting Policies

Description of the Company

Safeguard Scientifics, Inc. (Safeguard or the Company) seeks to build value in growing businesses by providing capital and strategic, operational and management resources. Safeguard participates in expansion financings, corporate spin-outs, management buyouts, recapitalizations, industry consolidations, and early-stage financings. The Company s vision is to be the preferred catalyst to build great companies across diverse capital platforms.

The Company strives to create long-term value for our shareholders by helping partner companies increase their market penetration, grow revenue and improve cash flow. The Company focuses principally on companies that operate in two sectors and in which it anticipates deploying up to $25 million. The two sectors on which the Company presently focuses are:

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

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

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

Basis of Presentation

The Company s Consolidated Financial Statements include the accounts of Clarient Inc. (Clarient) in continuing operations through May 14, 2009, the date of its deconsolidation. Clarient was acquired by GE Healthcare in December 2010. The Company had elected to apply the fair value option to account for its retained interest in Clarient upon deconsolidation. Unrealized gains and losses on the mark-to-market of its holdings in Clarient and realized gains and losses on the sale of any of its holdings in Clarient were recognized in Other income (loss), net in the Consolidated Statement of Operations for all periods subsequent to the date that Clarient was deconsolidated through the date of its disposition (see Note 3). The Company believes that accounting for its holdings in Clarient at fair value rather than applying the equity method of accounting provided a better measure of the value of its holdings, given the reliable evidence provided by quoted prices in an active market for Clarient s publicly traded common stock. The Company has not elected the fair value option for its other partner company holdings, which are accounted for under the equity method or cost method, due to less readily determinable evidence of fair value for these privately held companies and due to the potential competitive disadvantage to the Company of such disclosure.

The Company s ownership interests in Tengion, Inc. (Tengion) and NuPathe, Inc. (NuPathe) are accounted for as available-for-sale securities following Tengion s and NuPathe s completion of initial public offerings in April 2010 and August 2010, respectively.

In February 2011, the Company increased its ownership interest in MediaMath, Inc. (MediaMath) to 22.4%, above the threshold at which the Company believes it exercises significant influence. Accordingly, the Company adopted the equity method of accounting for its holdings in MediaMath. The Company has adjusted the financial statements for all prior periods presented to retrospectively apply the equity method of accounting for its holdings in MediaMath since the initial date of acquisition in July 2009 (see Note 20).

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Principles of Accounting for Ownership Interests in Companies

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

In addition to holding voting and non-voting equity and debt securities, the Company also periodically makes advances to its partner companies in the form of promissory notes which are included in the Ownership interests in and advances to partner companies and funds line item in the Consolidated Balance Sheet.

Consolidation Method. The Company generally accounts for partner companies in which it directly or indirectly owns more than 50% of the outstanding voting securities under the consolidation method of accounting. Under this method, the Company includes the partner companies financial statements within the Company s Consolidated Financial Statements, and all significant intercompany accounts and transactions are eliminated. The Company reflects participation of other stockholders in the net assets and in the income or losses of these consolidated partner companies in Equity in the Consolidated Balance Sheets and in Net (income) loss attributable to noncontrolling interest in the Statements of Operations. Net (income) loss attributable to noncontrolling interest adjusts the Company s consolidated operating results to reflect only the Company s share of the earnings or losses of the consolidated partner company. The Company accounts for results of operations and cash flows of a consolidated partner company through the latest date in which it holds a controlling interest. If the Company subsequently relinquishes control but retains an interest in the partner company, the accounting method is adjusted to the equity, cost or fair value method of accounting, as appropriate. As of and for the year ended December 31, 2011, the Company did not hold a controlling interest in any of its partner companies.

Fair Value Method. The Company accounted for its holdings in Clarient, formerly a publicly traded partner company, under the fair value method of accounting following its deconsolidation on May 14, 2009 and through the date of the sale of the Company s remaining interest in Clarient in December 2010. Unrealized gains and losses on the mark-to-market of the Company s holdings in Clarient and realized gains and losses on the sale of any holdings in Clarient were recognized in Other income (loss), net in the Consolidated Statements of Operations. As of and for the year ended December 31, 2011, the Company did not apply the fair value method to account for its holdings in any of its partner companies.

Equity Method. The Company accounts for partner companies whose results are not consolidated, but over which it exercises significant influence, under the equity method of accounting. Whether or not the Company exercises significant influence with respect to a partner company depends on an evaluation of several factors including, among others, representation of the Company on the partner company s board of directors and the Company s ownership level, which is generally a 20% to 50% interest in the voting securities of a partner company, including voting rights associated with the Company s holdings in common, preferred and other convertible instruments in the company. The Company also accounts for its interests in some private equity funds under the equity method of accounting based on its non-controlling general and limited partner interests in such funds. Under the equity method of accounting, the Company does not reflect a partner company s financial statements within the Company s Consolidated Financial Statements; however, the Company s share of the income or loss of such partner company is reflected in Equity loss in the Consolidated Statements of Operations. The Company includes the carrying value of equity method partner companies in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets. The Company reflects its share of the income or loss of the equity method partner companies on a one quarter lag. This reporting lag could result in a delay in recognition of the impact of changes in the business or operations of these partner companies.

When the Company s carrying value in an equity method partner company is reduced to zero, the Company records no further losses in its Consolidated Statements of Operations unless the Company has an outstanding guarantee obligation or has committed additional funding to such equity method partner company.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

When such equity method partner company subsequently reports income, the Company will not record its share of such income until it exceeds the amount of the Company s share of losses not previously recognized.

Cost Method. The Company accounts for partner companies not consolidated or accounted for under the equity method or fair value method under the cost method of accounting. Under the cost method, the Company does not include its share of the income or losses of partner companies in the Company s Consolidated Statements of Operations. The Company includes the carrying value of cost method partner companies in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

Available-for-Sale Securities. The Company accounts for its ownership interests in Tengion and NuPathe, both publicly traded entities at December 31, 2011, as available-for-sale securities. Available-for-sale securities are carried at fair value, based on quoted market prices, with the unrealized gains and losses, net of tax, reported as a separate component of equity. Unrealized losses are charged against net income (loss) when a decline in the fair value is determined to be other than temporary.

Accounting Estimates

The preparation of the Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and judgments that affect amounts reported in the financial statements and accompanying notes. Actual results may differ from these estimates. These estimates include the evaluation of the recoverability of the Company s ownership interests in and advances to partner companies and funds and investments in marketable securities, income taxes, stock-based compensation and commitments and contingencies. Following the deconsolidation of Clarient on May 14, 2009, the Company no longer records goodwill, intangible assets or revenue in its consolidated financial statements. Management evaluates its estimates on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances.

Certain amounts recorded to reflect the Company s share of income or losses of partner companies accounted for under the equity method are based on unaudited results of operations of those companies and may require adjustments in the future when audits of these entities financial statements are completed.

It is reasonably possible that the Company s accounting estimates with respect to the ultimate recoverability of the carrying value of the Company s ownership interests in and advances to partner companies and funds could change in the near term and that the effect of such changes on the financial statements could be material. At December 31, 2011, the Company believes the recorded amount of carrying value of the Company s ownership interests in and advances to partner companies and funds is not impaired, although there can be no assurance that the Company s future results will confirm this assessment, that a significant write-down or write-off will not be required in the future, or that a significant loss will not be recorded in the future upon the sale of a company.

Cash and Cash Equivalents and Marketable Securities

The Company considers all highly liquid instruments with an original maturity of 90 days or less at the time of purchase to be cash equivalents. Cash and cash equivalents consist of deposits that are readily convertible into cash. The Company determines the appropriate classification of marketable securities at the time of purchase and reevaluates such designation as of each balance sheet date. Held-to-maturity securities are carried at amortized cost, which approximates fair value. Marketable securities consist of held-to-maturity securities, primarily consisting of government agency bonds, commercial paper and certificates of deposits. Marketable securities with a maturity date greater than one year from the balance sheet date are considered long-term. The Company has not experienced any significant losses on cash equivalents and does not believe it is exposed to any significant credit risk on cash and cash equivalents.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted Cash Equivalents

Restricted cash equivalents consist of certificates of deposit with various maturity dates. Pursuant to the terms of the 10.125% senior convertible debentures, due March 14, 2014, the Company placed funds in a restricted escrow account to make all scheduled interest payments on the 2014 Debentures through their maturity date (see Note 7).

Financial Instruments

The Company s financial instruments (principally cash and cash equivalents, marketable securities, restricted cash equivalents, accounts receivable, notes receivable, accounts payable and accrued expenses) are carried at cost, which approximates fair value due to the short-term maturity of these instruments. The Company s warrant participations are carried at fair value. The Company s long-term debt is carried at cost. At December 31, 2011, the market value of the Company s outstanding 2014 Debentures was approximately $61.0 million based on quoted market prices as of that date. At December 31, 2011, the market value of the Company s outstanding 2024 Debentures approximated carrying value based on quoted market prices as of that date.

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

In 2011, the Company acquired a 36% ownership interest in the management company and general partner of Penn Mezzanine L.P. Penn Mezzanine is a mezzanine lender focused on lower middle-market, Mid-Atlantic companies. Through its relationship with Penn Mezzanine, the Company may acquire participating interests in mezzanine loans and related equity interests of the borrowers. These interests may also include warrants to purchase common stock of the borrowers. The Company s accounting policies for these participating interests are as follows:

Loan Participations Receivable

The Company s participating interest in Penn Mezzanine loans are included in Loan Participations receivable on the Consolidated Balance Sheet. In connection with each financing transaction, Penn Mezzanine assesses the credit worthiness of the borrower through various standard industry metrics including leverage ratios, working capital metrics, cash flow projections and an overall evaluation of the borrower s business model. The Company uses these analyses in making its determination to participate in any funding.

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

Penn Mezzanine charges fees to borrowers for originating loans. The Company s participating interest in these fees, net of any loan origination costs, are deferred and amortized to income using the effective interest method, over the term of the loan. If the loan is repaid prior to maturity, the remaining unamortized deferred loan origination fee is recognized in income at the time of repayment. Unamortized deferred loan origination fees are recorded as a contra asset against Loan participations receivable on the Consolidated Balance Sheets.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Equity Participations

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

Warrant Participations

The Company recognizes its participation in warrants acquired by Penn Mezzanine based on the fair value of the warrants at the balance sheet date. The fair values of warrant participations are bifurcated from the related loan participations receivable based on the relative fair value of the respective instruments at the acquisition date. The resulting discount is amortized to interest income over the term of the loan using the effective interest method. Any gain or loss associated with changes in the fair value of the warrants at the balance sheet date is recorded in Other income (loss), net in the Consolidated Statements of Operations. The fair value of the warrants is determined based on Level 3 inputs and is included in Other assets on the Consolidated Balance Sheets.

Property and Equipment

Property and equipment are stated at cost. Provision for depreciation and amortization is based on the lesser of the estimated useful lives of the assets or the remaining lease term (buildings and leasehold improvements, 5 to 15 years; machinery and equipment, 3 to 15 years) and is computed using the straight-line method.

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

On a periodic basis, but no less frequently than quarterly, the Company evaluates the carrying value of its equity and cost method partner companies and available-for-sale securities for possible impairment based on achievement of business plan objectives and milestones, the fair value of each partner company relative to its carrying value, the financial condition and prospects of the partner company and other relevant factors. The business plan objectives and milestones the Company considers include, among others, those related to financial performance, such as achievement of planned financial results or completion of capital raising activities, and those that are not primarily financial in nature, such as hiring of key employees or the establishment of strategic relationships. Management then determines whether there has been an other than temporary decline in the value of its ownership interest in the company. Impairment is measured by the amount by which the carrying value of an asset exceeds its fair value.

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 the Company s ownership interests in private equity funds generally is determined based on the value of its pro rata portion of the fair value of the funds net assets.

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

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

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Defined Contribution Plans

Defined contribution plans are contributory and cover eligible employees of the Company. The Company s defined contribution plan allows eligible employees, as defined in the plan, to contribute to the plan up to 75% of their pre-tax compensation, subject to the maximum contributions allowed by the Internal Revenue Code. The Company makes matching contributions under the plan. Expense relating to defined contribution plans was $0.3 million in 2011, $0.3 million in 2010 and $0.4 million in 2009.

Income Taxes

The Company accounts for income taxes under the asset and liability method whereby deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The Company measures deferred tax assets and liabilities using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. The Company recognizes the effect on deferred tax assets and liabilities of a change in tax rates in income in the period of the enactment date. The Company provides valuation allowances against the net deferred tax asset for amounts which are not considered more likely than not to be realized.

Net income (loss) per share attributable to Safeguard Scientifics, Inc.

The Company computes net income (loss) per share (EPS) using the weighted average number of common shares outstanding during each year. The Company includes in diluted EPS common stock equivalents (unless anti-dilutive) which would arise from the exercise of stock options and conversion of other convertible securities and is adjusted, if applicable, for the effect on net income (loss) of such transactions. Diluted EPS calculations adjust net income (loss) for the dilutive effect of common stock equivalents and convertible securities issued by the Company s consolidated or equity method partner companies.

Comprehensive income (loss) attributable to Safeguard Scientifics, Inc.

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

Segment Information

The Company reports segment data based on the management approach which designates the internal reporting used by management for making operating decisions and assessing performance as the source of the Company s reportable operating segments.

New Accounting Pronouncements

The Company will adopt the following new accounting standards as of January 1, 2012:

Amendment to Fair Value Measurement: The guidance clarifies the Financial Accounting Standards Board s (FASB) intent about the application of existing fair value measurements and requires enhanced disclosures, most significantly related to unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy. The guidance is effective prospectively during interim and annual periods beginning after December 15, 2011. The adoption of the amendment to fair value measurement is not expected to have a significant impact on the Company s Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Amendment to Comprehensive Income: Under the FASB amended guidance, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in a single continuous statement or in two separate but consecutive statements. The amended guidance eliminates the previously available option of presenting the components of other comprehensive income as part of the statement of changes in equity. The amendment is effective for fiscal years beginning after December 15, 2011 and will be applied retrospectively.

2. Discontinued Operations

The following items are related to discontinued operations.

Acsis, Alliance Consulting and Laureate Pharma

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

Of the gross proceeds to the Company from the Bundle Transaction, $6.4 million was placed in escrow pending expiration of a claims period and remains in escrow as of December 31, 2011 (see Note 15).

Clarient Technology Business

In March 2007, Clarient sold its technology business and related intellectual property to Carl Zeiss MicroImaging, Inc. (Zeiss) for an aggregate purchase price of $12.5 million. The $12.5 million consisted of $11.0 million in cash and an additional $1.5 million in contingent purchase price, subject to the satisfaction of certain post-closing conditions through March 2009. Clarient received the contingent consideration and recorded the $1.5 million in income from discontinued operations in 2009.

Pacific Title & Art Studio

In March 2007, the Company sold Pacific Title & Art Studio for net cash proceeds of approximately $21.9 million, including $2.3 million in cash deposited into escrow. In the first quarter of 2010, the Company received the final $0.5 million in cash from the escrow account. This amount was recorded in income from discontinued operations in 2009.

3. Ownership Interests in and Advances to Partner Companies and Funds

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

	December 31, 2011	December 31, 2010
	(In thousands)	
Equity Method:		
Partner companies	$ 104,545	$ 50,561
Private equity funds	5,784	2,265
	110,329	52,826

Cost Method:		
Private equity funds	2,984	2,908
Advances to partner companies	856	4,522
	$ 114,169	$ 60,256
Loan participations receivable	$ 7,587	$
Available-for-sale securities	$ 5,184	$ 25,447

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company recognized an impairment charge of $5.9 million in 2011 which is reflected in Other income (loss), net, in the Consolidated Statements of Operations, representing the unrealized loss on the mark-to-market of its ownership in NuPathe which was previously recorded as a separate component of equity. The Company determined that the decline in value of its public holdings in NuPathe was other than temporary. Following the impairment charge, the Company s adjusted cost basis in NuPathe was $4.9 million at December 31, 2011.

The Company recognized impairment charges totaling $1.5 million in 2011 which are reflected in Other income (loss), net, in the Consolidated Statements of Operations, representing the unrealized loss on the mark-to-market of its ownership interest in Tengion, which was previously recorded as a separate component of equity. The Company determined that the decline in the value of its public holdings in Tengion was other than temporary. The Company had previously recognized impairment charges of $1.1 million for the year ended December 31, 2010. Following the impairment charge, the Company s adjusted cost basis in Tengion was $0.3 million at December 31, 2011.

There were no impairment charges related to cost method partner companies in 2011. Impairment charges related to cost method partner companies were $2.1 million and $10.1 million for the years ended December 31, 2010 and 2009, respectively. The charge in 2010 related to Tengion, prior to its classification as an available-for-sale security. The charges in 2009 included $5.8 million related to GENBAND, a former partner company, $3.9 million related to Tengion and $0.4 million related to a private equity fund.

Impairment charges related to equity method partner companies were $7.1 million, $4.8 million and $4.1 million for the years ended December 31, 2011, 2010 and 2009 respectively. The impairment charges in 2011 included $5.7 million related to Swap.com and $1.4 million related to SafeCentral, Inc. (SafeCentral formerly Authentium, Inc.). The impairment charges in 2010 included $1.8 million related to Molecular Biometrics, Inc. (Molecular Biometrics), $1.5 million related to SafeCentral, $1.1 million related to Garnet BioTherapeutics, Inc. (Garnet) and $0.4 million related to Acelerate, Inc. (Acelerate), formerly Cellumen, Inc.), a former partner company. The impairment charges in 2009 included $3.3 million related to Rubicor Medical, Inc. (Rubicor), a former partner company and $0.8 million related to Acelerate.

In July 2011, Portico Systems, Inc. (Portico), formerly an equity method partner company, was acquired by McKesson. The Company received cash proceeds in exchange for its equity interests of approximately $32.8 million, excluding $3.4 million which will be held in escrow for a period of one year. In addition, depending on the achievement of certain milestones, the Company may receive up to an additional $1.9 million after a period of one year. Portico also repaid its mezzanine loan facility with the Company in the principal amount of $5.0 million in connection with the transaction. The Company recorded a gain of $35.4 million on the transaction which is recorded in Equity income (loss) in the Consolidated Statement of Operations.

In June 2011, Advanced BioHealing, Inc. (Advanced BioHealing), formerly an equity method partner company, was acquired by Shire plc, resulting in net sale proceeds to the Company of $138.2 million, excluding cash held in escrow of $7.6 million. The Company recognized a gain on sale of $129.3 million which is reflected in Equity income (loss) in the Consolidated Statement of Operations.

In December 2010, Avid Radiopharmaceuticals, Inc. (Avid), formerly a cost method partner company, was acquired by Eli Lily and Company resulting in net sale proceeds to the Company of $32.3 million, excluding cash held in escrow of $3.4 million. The Company recognized a gain on the sale of $20.3 million. In addition, depending on the achievement of certain difficult milestones, the Company could receive additional proceeds of up to $58.0 million over an eight year period.

In December 2010, the Company sold its equity and debt interests in Quinnova Pharmaceuticals, Inc. (Quinnova) for $2.6 million, recognizing a loss on sale of $0.9 million, which is reflected in Equity income (loss) in the Consolidated Statement of Operations. The Company may realize additional proceeds of up to $1.9 million.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In March 2009, Clarient entered into a stock purchase agreement with Oak Investment Partners XII (Oak), pursuant to which Clarient agreed to sell up to an aggregate of 6.6 million shares of its Series A Convertible Preferred Stock in two or more tranches for aggregate consideration of up to $50.0 million. Each preferred share was initially convertible, at any time, into four shares of Clarient s common stock, subject to certain adjustments. The initial closing of the Oak private placement occurred on March 26, 2009, at which time Clarient issued 3.8 million preferred shares for aggregate consideration of $29.1 million. After paying closing fees and legal expenses, Clarient used the proceeds to repay in full and terminate its revolving credit agreement with a bank and repay a portion of the outstanding balance of its credit facility with the Company.

Later during 2009, the Company publicly sold 18.4 million shares of common stock of Clarient for $61.3 million in net proceeds. The Company recognized a loss of $7.3 million on the sale, based on the net proceeds received compared to the fair value at the end of the previous quarter, which is included in Other income (loss), net in the Consolidated Statements of Operations for the year ended December 31, 2009.

In December 2010, Clarient was acquired by GE Healthcare. The Company received gross proceeds of $153.4 million in connection with the transaction and paid retention bonuses to Clarient management of $6.9 million, resulting in net proceeds of $146.5 million. The Company recognized a gain of $43.0 million on the transaction, based on the net proceeds received compared to the fair value at the end of the previous quarter which was included in Other income (loss), net in the Consolidated Statements of Operations.

For the period from January 1, 2010 through September 30, 2010, the Company recognized unrealized gains of $22.4 million on the mark-to-market of its holdings in Clarient which were included in Other income (loss), net in the Consolidated Statements of Operations. For the period from May 14, 2009 through December 31, 2009, the Company recognized unrealized gains of $19.5 million on the mark-to-market of its holdings in Clarient.

The following unaudited summarized balance sheet for Clarient at September 30, 2010 and the results of operations for the nine months ended September 30, 2010, have been compiled from the unaudited financial statements of Clarient. The results of Clarient are reported on a one quarter lag.

	September 30, 2010 (In thousands) (unaudited)
Balance Sheet:	
Current assets	$ 42,758
Non-current assets	32,392
Total Assets	$ 75,150
Current liabilities	$ 14,241
Non-current liabilities	4,626
Redeemable preferred stock	38,586
Shareholders equity	17,697
Total liabilities and shareholders equity	$ 75,150

	Nine Months Ended September 30, 2010 (In thousands) (unaudited)

Results of Operations:		
Revenue	$	86,803
Operating income	$	3,564
Net income from continuing operations	$	2,914

58

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following unaudited summarized financial information for partner companies and funds accounted for under the equity method at December 31, 2011 and 2010 and for the three years ended December 31, 2011, has been compiled from the unaudited financial statements of our respective partner companies and funds and reflects certain historical adjustments. Results of operations of the partner companies and funds are excluded for periods prior to their acquisition and subsequent to their disposition. The unaudited financial information below does not include information pertaining to Clarient.

	As of December 31,	
	2011	2010
	(In thousands) (unaudited)	
Balance Sheets:		
Current assets	$ 156,497	$ 131,733
Non-current assets	72,911	61,867
Total Assets	$ 229,408	$ 193,600
Current liabilities	$ 64,568	$ 64,763
Non-current liabilities	33,856	29,676
Shareholders equity	130,984	99,161
Total liabilities and shareholders equity	$ 229,408	$ 193,600

As of December 31, 2011, the Company s carrying value in equity method partner companies, in the aggregate, exceeded the Company s share of the net assets of such companies by approximately $69.3 million. Of this excess, $35.5 million was allocated to goodwill and $33.8 million was allocated to intangible assets.

	Year Ended December 31,		
	2011	2010	2009
		(In thousands) (unaudited)	
Results of Operations:			
Revenue	$ 114,264	$ 238,477	$ 146,291
Gross profit	$ 63,009	$ 162,820	$ 98,626
Net loss	$ (35,563)	$ (22,934)	$ (50,505)

4. Acquisitions of Ownership Interests in Partner Companies and Funds

In August 2011, the Company acquired a 36% ownership interest in the management company and general partner of Penn Mezzanine for $3.9 million. Penn Mezzanine is a mezzanine lender focused on lower middle-market, Mid-Atlantic companies. The Company accounts for its interest in Penn Mezzanine under the equity method of accounting. The Company expects to deploy up to $26.1 million (including $9.7 million deployed in the fourth quarter of 2011 as described below) in additional capital over a several year period in mezzanine opportunities alongside existing and future Penn Mezzanine funds.

In December and November 2011, the Company funded an aggregate of $9.7 million for participations in certain loans and equity interests initiated by Penn Mezzanine. Included in this funding was $8.1 million for participation in loans and $1.3 million for participations in equity interests acquired by Penn Mezzanine. The Company also participated in warrants to acquire common stock of certain borrowers. The fair value of the warrants at December 31, 2011 was determined to be $0.3 million. The Company accounts for the loan portion of the participation as a loan receivable and reports these amounts as Loan participations receivable on the

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consolidated Balance Sheets. The Company accounts for its participation in equity interests under the cost method and reports these amounts in Other assets on the Consolidated Balance Sheets. The Company accounts for its participation in warrants to acquire common stock at fair value and reports these amounts in Other assets on the Consolidated Balance Sheets. During the year, the Company received $0.2 million in loan origination fees. The unamortized deferred loan origination fee balance as of December 31, 2011 was $0.2 million. In addition, at December 31, 2011 the Company had recorded $0.3 million in original issue discount associated with its participation in the loans which is recorded net of Loan participations receivable in the Consolidated Balance Sheets.

In December 2011, the Company acquired a 23.9% ownership interest in Crimson Informatics, Inc. (Crimson) for $1.7 million. Crimson is a provider of telematics technology and statistical analysis of driving data. The Company accounts for its interest in Crimson under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Crimson was preliminarily allocated to goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In December 2011, the Company acquired a 28.0% ownership interest in Hoopla Software, Inc. for $1.3 million. Hoopla helps organizations create high performance sales cultures through SaaS solutions that integrate with CRM systems. The Company accounts for its interest in Hoopla under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Hoopla was preliminarily allocated to goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In November 2011, the Company acquired a 30.0% ownership interest in Medivo, Inc. (Medivo) for $6.3 million. Medivo is a healthcare IT company that connects patients to a nationwide network of physicians, lab service centers and home testing services. The Company accounts for its interest in Medivo under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Medivo was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In September 2011, the Company acquired a 30.1% ownership interest in Putney, Inc. (Putney) for $10.0 million. Putney is a specialty pharmaceutical company focused on providing generic medicines for pets. The Company accounts for its interest in Putney under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Putney was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In August 2011, the Company funded $2.4 million of a convertible bridge loan to Swap.com. The Company had previously deployed an aggregate of $8.1 million in Swap.com. Swap.com is an internet based business that enables users to trade books, music, movies, video games and fashion using its proprietary trade matching software. The Company accounts for its interest in Swap.com under the equity method.

In July 2011, the Company deployed $1.2 million in MediaMath, Inc. (MediaMath). In February 2011, the Company deployed $9.0 million in MediaMath. In conjunction with this funding, the Company s ownership interest in MediaMath increased from 17.3% to 22.4%, above the threshold at which the Company believes it exercises significant influence. Accordingly, the Company adopted the equity method of accounting for its holdings in MediaMath. See Note 20 regarding the change in accounting treatment for the Company s holdings in MediaMath from the cost method to the equity method. The Company previously had acquired an interest in MediaMath in July 2009 for $6.7 million. MediaMath is an online media trading company that enables advertising agencies and their advertisers to optimize their ad spending across various exchanges through its proprietary algorithmic bidding platform and data integration technology. The difference between the Company s cost and its interest in the underlying net assets of MediaMath was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In June 2011, the Company acquired a 31.7% ownership interest in NovaSom, Inc. (NovaSom) for $20.0 million. NovaSom provides diagnostic devices and services for home testing and evaluation of sleep-disordered breathing, including obstructive sleep apnea. The Company accounts for its interest in NovaSom under the equity method. The difference between the Company s cost and its interest in the underlying net assets of NovaSom was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In April 2011, the Company acquired a 24.7% ownership interest in PixelOptics Inc. (PixelOptics) for $25.0 million. PixelOptics provides electronic corrective eyeglasses designed to substantially reduce or eliminate the visual distortion and other limitations associated with multifocal lenses. The Company accounts for its interest in PixelOptics under the equity method. The difference between the Company s cost and its interest in the underlying net assets of PixelOptics was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In October and April 2011, the Company funded an aggregate of $1.4 million of a convertible bridge loan to Alverix, Inc. (Alverix). The Company previously deployed an aggregate of $6.3 million in Alverix. Alverix provides next-generation instrument and connectivity platforms for diagnostic Point-of-Care (POC) testing. The Company accounts for its holdings in Alverix under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Alverix was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In February 2011, the Company acquired a 30.7% ownership interest in ThingWorx, Inc. (ThingWorx) for $5.0 million. ThingWorx offers a platform designed to accelerate the development of applications connecting people, systems and devices. The Company accounts for its holdings in ThingWorx under the equity method. The difference between the Company s cost and its interest in the underlying net assets of ThingWorx was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In December 2010, the Company funded a $5.0 million mezzanine debt financing to Portico Systems, Inc. (Portico). The Company previously deployed an aggregate of $9.3 million in cash in Portico from August 2006 through April 2009. In July 2011, Portico was acquired by McKesson resulting in net sale proceeds to the Company of $32.8 million, excluding cash held in escrow of $3.4 million. The Company accounted for its holdings in Portico under the equity method.

In December 2010, the Company deployed an additional $1.8 million in Advantedge Healthcare Solutions, Inc. (AHS). In March 2010, the Company funded a $1.3 million short-term loan to AHS which was repaid in May 2010. The Company previously deployed a total of $13.5 million into AHS. AHS is a provider of physician billing and practice management services and software to hospital-based physician groups, large office-based physician practices, and ambulatory surgery centers. The Company accounts for its holdings in AHS under the equity method. The difference between the Company s cost and its interest in the 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 partner companies and funds on the Consolidated Balance Sheets.

In September 2010, the Company exercised a total of $0.6 million of warrants in Clarient. The Company sold its remaining interest in Clarient in December 2010 for net proceeds of $146.5 million, recognizing a gain on sale of $43.0 million.

In September 2010, the Company acquired a 26.5% ownership interest in Good Start Genetics, Inc. (Good Start) for $6.8 million. Good Start has developed a pre-pregnancy genetic test, which utilizes an advanced DNA

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

sequencing technology to screen for a panel of genetic disorders, including those recommended by the American Congress of Obstetricians and Gynecologists and the American College of Medical Genetics. The Company accounts for its interest in Good Start under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Good Start was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In September and June 2010, the Company funded an aggregate of $0.7 million in convertible bridge loans to Quinnova. The Company previously deployed $5.0 million in Quinnova in October 2009. The Company sold its equity and debt interests in Quinnova in December 2010 for $2.6 million, recognizing a loss on sale of $0.9 million. The Company accounted for its interest in Quinnova under the equity method.

In August 2010, in conjunction with NuPathe s initial public offering, the Company deployed an additional $3.5 million in NuPathe. In April 2010, the Company funded a $2.7 million convertible bridge loan to NuPathe, which was converted to common shares in conjunction with the initial public offering. The Company previously deployed $12.0 million in NuPathe from August 2006 through August 2009. NuPathe is a specialty pharmaceutical company focused on the development and commercialization of branded therapeutics for diseases of the central nervous system, including neurological and psychiatric disorders. Following NuPathe s initial public offering, the Company accounts for its holdings in NuPathe as available-for-sale securities and holds a 17.8% ownership interest.

In April 2010, in conjunction with Tengion s initial public offering, the Company deployed an additional $1.5 million in Tengion. The Company previously deployed $7.5 million in Tengion in 2008. Tengion is a clinical-stage biotechnology company. It has pioneered the Organ Regeneration Platform™ that enables the Company to create proprietary product candidates that are intended to harness the intrinsic regenerative pathways of the body to produce a range of native-like organs and tissues. Following Tengion s initial public offering, the Company accounts for its holdings in Tengion as available-for-sale securities and holds a 2.5% ownership interest.

In December, May and February 2009, the Company deployed an aggregate of $6.5 million in Molecular Biometrics. The Company had previously acquired an interest in Molecular Biometrics in 2008, for $3.5 million in cash, including the conversion into equity interests of $1.9 million previously advanced to the company. The Company impaired all of the carrying value of Molecular Biometrics in 2010 and no longer holds an active interest in the company. The Company accounted for its holdings in Molecular Biometrics under the equity method.

In October, May and February, 2009 the Company provided additional funding of $0.8 million to Acelerate, Inc., as part of an up to $2.5 million convertible note financing to be funded in five tranches. The Company previously acquired an interest in Acelerate in 2007, deploying $6.0 million in cash. During 2010, the assets of Acelerate, Inc. were sold to a third party for cash and future consideration based on sales milestones. The Company received no proceeds from this transaction and does not expect to receive any proceeds related to future milestones. The Company accounted for its interest in Acelerate under the equity method.

In 2009 and 2008, the Company deployed an aggregate of $4.0 million in Garnet. The Company accounted for its holdings in Garnet under the equity method. In the third quarter of 2010, the Company impaired the carrying value of Garnet to zero.

In 2009 and 2007, the Company deployed an aggregate of $12.0 million in Avid for a 13.7% ownership interest. In December 2010, Avid was acquired by Eli Lily and Company resulting in net sale proceeds to the Company of $32.3 million, excluding cash held in escrow of $3.4 million. The Company accounted for its holdings in Avid under the cost method.

In March 2009, the Company deployed an additional $2.0 million in Bridgevine, Inc. (Bridgevine). The Company had previously acquired an interest in Bridgevine in 2007 for $8.0 million. Bridgevine is an internet

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

marketing company that enables online consumers to compare and purchase digital services, including internet, phone, VoIP, TV, wireless, music, and entertainment. The Company accounts for its holdings in Bridgevine under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Bridgevine was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

5. Fair Value Measurements

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

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

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

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

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following table provides the assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 and 2010:

	Carrying Value	Fair Value Measurement at December 30, 2011		
		Level 1	Level 2	Level 3
		(in thousands) (unaudited)		
Cash and cash equivalents	$ 83,187	$ 83,187	$	$
Cash held in escrow	$ 6,433	$ 6,433	$	$
Restricted cash equivalents	$ 12,265	$ 12,265	$	$
Available-for-sale securities	$ 5,184	$ 5,184	$	$
Warrant participations	$	$	$	$ 276
Marketable securities held-to-maturity:				
Commercial paper	$ 42,919	$ 42,919	$	$
U.S. Treasury Bills	17,555	17,555		
Government agency bonds	66,422	66,422		
Corporate bonds	1,015	1,015		
Certificates of deposit	30,187	30,187		
	$ 158,098	$ 158,098	$	$

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Carrying Value	Fair Value Measurement at December 31, 2010		
		Level 1	Level 2	Level 3
		(in thousands)		
Cash and cash equivalents	$ 183,419	$ 183,419	$	$
Cash held in escrow	$ 6,434	$ 6,434	$	$
Restricted cash equivalents	$ 16,774	$ 16,774	$	$
Available-for-sale securities	$ 25,447	$ 25,447	$	$
Marketable securities held-to-maturity:				
Commercial paper	$ 27,362	$ 27,362	$	$
U.S. Treasury Bills	12,053	12,053		
Government agency bonds	2,996	2,996		
	$ 42,411	$ 42,411	$	$

As of December 31, 2011, $158.1 million of marketable securities had contractual maturities which were less than one year and $16.3 million of marketable securities had contractual maturities greater than one year. Held-to-maturity securities are carried at amortized cost, which, due to the short-term maturity of these instruments, approximates fair value using quoted prices in active markets for identical assets or liabilities defined as Level 1 inputs under the fair value hierarchy.

The Company s warrant participations are carried at fair value. The value of the Company s holdings in warrant participations is measured by reference to Level 3 inputs. The inputs and valuation techniques used include discounted cash flows and valuation of comparable public companies.

The Company recorded an impairment charge of $5.7 million related to Swap.com in 2011 measured as the amount by which Swap.com s carrying value exceeded its estimated fair value. The fair market value of the Company s interest in Swap.com was determined to be zero based on Level 3 inputs as defined above. The inputs and valuation techniques used include discounted cash flows and valuation of comparable public companies.

Following NuPathe s initial public offering, the Company accounts for its holdings in NuPathe as available-for-sale securities. The Company recognized an impairment charge of $5.9 million in 2011 representing the unrealized loss on the mark-to-market of its ownership in NuPathe which was previously recorded as a separate component of equity. The value of the Company s holdings in NuPathe was measured by reference to quoted prices for NuPathe s common stock as traded on the NASDAQ Capital Market, which is considered a Level 1 input under the valuation hierarchy.

The Company recorded an impairment charge of $1.4 million related to SafeCentral in 2011 measured as the amount by which SafeCentral s carrying value exceed its estimated fair value. The fair market value of the Company s interest in SafeCentral was determined to be $0.8 million based on Level 3 inputs as defined above. The inputs and valuation techniques used include discounted cash flows and valuation of comparable public companies.

Following Tengion s initial public offering, the Company accounts for its holdings in Tengion as available-for-sale securities. The Company recognized impairment charges of $1.5 million in 2011, representing the unrealized loss on the mark-to-market of its ownership interest in Tengion which was previously recorded as a separate component of equity. The Company recognized impairment charges of $1.1 million related to Tengion in 2010. In each case, the value of the Company s holdings in Tengion was measured by reference to quoted prices for Tengion s common stock as traded on the NASDAQ Capital Market, which is considered a Level 1 input under the valuation hierarchy.

64

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Prior to its sale in December 2010, the Company s holdings in Clarient were measured at fair value using quoted prices for Clarient s common stock as traded on the NASDAQ Capital Market, which is considered a Level 1 input under the valuation hierarchy.

As described in Note 7, in 2010, the Company recognized a loss on exchange of its convertible senior debentures. The fair value of the newly issued 10.125% convertible senior debentures was determined at the exchange date based on Level 3 inputs using a convertible bond valuation model.

As described in Note 3, the Company recognized impairment charges of $2.1 million related to a cost method partner company and $4.8 million related to equity method partner companies during the year ended December 31, 2010 measured as the amount by which the partner companies carrying values exceeded their respective estimated fair values. The inputs and valuation techniques used include discounted cash flows and valuation of comparable public companies.

6. Property and Equipment

Property and equipment consisted of the following:

	As of December 31,	
	2011	2010
	(In thousands)	
Building and improvements	$ 547	$ 503
Machinery and equipment	997	985
	1,544	1,488
Accumulated depreciation	(1,316)	(1,193)
	$ 228	$ 295

7. Convertible Debentures and Credit Arrangements

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

	As of December 31,	
	2011	2010
	(In thousands)	
Convertible senior debentures due 2024	$ 441	$ 31,289
Convertible senior debentures due 2014	45,253	44,630
	45,694	75,919
Less: current portion		(31,289)
Convertible senior debentures non-current	$ 45,694	$ 44,630

Convertible Senior Debentures due 2024

In 2004, the Company issued an aggregate of $150 million in face value of convertible senior debentures with a stated maturity date of March 15, 2024 (the 2024 Debentures). The Company has $0.4 million of the 2024 Debentures outstanding at December 31, 2011. On March 21, 2011, the Company repurchased $30.8 million of the 2024 Debentures as required by the 2024 Debenture holders. Interest on the 2024 Debentures is payable semi-annually. At the debentures holders option, the 2024 Debentures are convertible into the Company s common stock through March 14, 2024, subject to certain conditions. The adjusted conversion rate of the debentures is $43.3044 of principal amount per share. The closing price of the Company s common stock at December 31, 2011 was $15.79. The remaining 2024 Debentures holders have the right to require the

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Company to repurchase the 2024 Debentures on March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their face amount, plus accrued and unpaid interest. In limited circumstances, the Company has the right to redeem all or some of the 2024 Debentures.

At December 31, 2011, the fair value of the $0.4 million outstanding 2024 Debentures approximated their carrying value based on quoted market prices as of such date.

Convertible Senior Debentures due 2014

In March 2010, the Company issued an aggregate of $46.9 million in face value of convertible senior debentures with a stated maturity of March 15, 2014 (the 2014 Debentures). Interest on the 2014 Debentures is payable semi-annually on March 15 and September 15. At the time of issuance, as required under the terms of the 2014 Debentures, the Company placed approximately $19.0 million in a restricted escrow account to make all scheduled interest payments on the 2014 Debentures through their maturity. During 2011 and 2010, interest payments of $4.8 million and $2.2 million, respectively, were made out of the restricted escrow account and are considered non-cash investing activities. Including accrued interest, a total of $12.3 million was reflected in Restricted cash equivalents on the Consolidated Balance Sheet at December 31, 2011, of which $5.1 million was classified as a current asset.

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

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

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

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

The conversion price is $16.50 of principal amount per share, equivalent to a conversion rate of 60.6061 shares of Company common stock per $1,000 principal amount of the 2014 Debentures. The closing price of the Company s common stock at December 31, 2011 was $15.79. The 2014 Debentures holders have the right to require repurchase of the 2014 Debentures upon a fundamental change, including sale of all or substantially all of the Company s common stock or assets, liquidation, dissolution or a change in control or the delisting of the Company s common stock from the New York Stock Exchange if the Company were unable to obtain a listing for its common stock on another national or regional securities exchange. None of the above conditions required for conversion were met as of December 31, 2011.

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

Because the 2014 Debentures may be settled in cash or partially in cash upon conversion, the Company separately accounts for the liability and equity components of the 2014 Debentures. The carrying amount of the liability component was determined at the exchange date by measuring the fair value of a similar liability that

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

does not have an associated equity component. The carrying amount of the equity component represented by the embedded conversion option was determined by deducting the fair value of the liability component from the carrying value of the 2014 Debentures as a whole at the exchange date. The carrying value of the 2014 Debentures as a whole at the exchange date was equal to their fair value of $55.2 million determined using a convertible bond valuation model. At December 31, 2011, the fair value of the $46.9 million outstanding 2014 Debentures was approximately $61.0 million based on quoted market prices as of such date. At December 31, 2011, the carrying amount of the equity component was $10.8 million, the principal amount of the liability component was $46.9 million, the unamortized discount was $1.7 million and the net carrying value of the liability component was $45.2 million. The Company is amortizing the excess of the face value of the 2014 Debentures over their carrying value to interest expense over their term. The effective interest rate on the 2014 Debentures is 12.5%.

Credit Arrangements

The Company is party to a loan agreement which provides it with a revolving credit facility in the maximum aggregate amount of $50 million in the form of borrowings, guarantees and issuances of letters of credit (subject to a $20 million sublimit). Actual availability under the credit facility is based on the amount of cash maintained at the bank as well as the value of the Company s public and private partner company interests. This credit facility bears interest at the prime rate for outstanding borrowings, subject to an increase in certain circumstances. Other than for limited exceptions, the Company is required to maintain all of its depository and operating accounts and the lesser of $80 million or 75% of its investment and securities accounts at the bank. The credit facility, as amended December 31, 2010, matures on December 31, 2012. Under the credit facility, the Company provided a $6.3 million letter of credit expiring on March 19, 2019 to the landlord of CompuCom Systems, Inc. s Dallas headquarters which has been required in connection with the sale of CompuCom Systems in 2004. Availability under the Company s revolving credit facility at December 31, 2011 was $43.7 million.

8. Accrued Expenses and Other Current Liabilities

Accrued expenses consisted of the following:

	As of December 31,	
	2011	**2010**
	(In thousands)	
Accrued interest	$ 1,403	$ 1,640
Other	2,287	2,583
	$ 3,690	$ 4,223

9. Equity

Preferred Stock

Shares of preferred stock, par value $0.10 per share, are voting and are issuable in one or more series with rights and preferences as to dividends, redemption, liquidation, sinking funds and conversion determined by the Board of Directors. At December 31, 2011 and 2010, there were one million shares authorized and none outstanding.

Shareholders Rights Plan

In February 2000, the Company adopted a shareholders rights plan. Under the plan, each shareholder of record on March 24, 2000 received the right to purchase 1/1000 of a share of the Company s Series A Junior Participating Preferred Stock at the rate of one right for each share of the

Company s common stock then held of record. Each 1/1000 of a share of the Company s Series A Junior Participating Preferred Stock is designed to be

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

equivalent in voting and dividend rights to one share of the Company s common stock. The rights would have become exercisable only if a person or group acquired beneficial ownership of 15% or more of the Company s common stock or commenced a tender or exchange offer that would have resulted in such a person or group owning 15% or more of the Company s common stock. This plan expired on March 1, 2010.

10. Stock-Based Compensation

Equity Compensation Plans

Under the amended and restated 2004 Equity Compensation Plan, employees, executive officers, directors and consultants are eligible for grants of stock options, restricted stock awards, stock appreciation rights, stock units, performance units and other stock-based awards. The 2004 Equity Compensation Plan has 2.2 million shares authorized for issuance. The 2001 Associates Equity Compensation Plan, with 0.9 million shares authorized for issuance, and the 1999 Equity Compensation Plan, with 1.5 million shares authorized for issuance, expired by their terms and no further grants may be made under those plans. During 2011, the Company issued 85 thousand options outside of existing plans as inducement awards in accordance with New York Stock Exchange rules.

To the extent allowable, service-based awards are incentive stock options. Options granted under the plans are at prices equal to or greater than the fair market value at the date of grant. Upon exercise of stock options, the Company issues shares first from treasury stock, if available, then from authorized but unissued shares. At December 31, 2011, the Company had reserved 4.3 million shares of common stock for possible future issuance under its equity compensation plans.

Classification of Stock-Based Compensation Expense

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

	Year Ended December 31,		
	2011	2010	2009
	(In thousands)		
Cost of sales	$	$	$ 49
Selling, general and administrative	3,052	3,777	3,776
	$ 3,052	$ 3,777	$ 3,825

At December 31, 2011, the Company had outstanding options that vest based on three different types of vesting schedules:

1) market-based;

2) performance-based; and

3) service-based.

Market-based awards entitle participants to vest in a number of options determined by achievement by the Company of certain target market capitalization increases (measured by reference to stock price increases on a specified number of outstanding shares) over an eight-year period. The requisite service periods for the market-based awards are based on the Company s estimate of the dates on which the market conditions will be met as determined using a Monte Carlo simulation model. Compensation expense is recognized over the requisite service periods using the straight-line method but is accelerated if market capitalization targets are achieved earlier than estimated. During the years ended December 31, 2011, 2010 and 2009, the Company did not issue

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

any market-based option awards to employees. During the years ended December 31, 2011, 2010 and 2009, respectively, 110 thousand, 21 thousand and 16 thousand market-based options vested based on achievement of market capitalization targets. During the years ended December 31, 2011, 2010 and 2009, respectively, 125 thousand, 10 thousand and 67 thousand market-based options were cancelled or forfeited. The Company recorded compensation expense related to these awards of $1.2 million, $1.7 million and $1.5 million during the years ended December 31, 2011, 2010 and 2009, respectively. Depending on the Company s stock performance, the maximum number of unvested shares at December 31, 2011 attainable under these grants was 1.0 million shares.

Performance-based awards entitle participants to vest in a number of awards determined by achievement by the Company of target capital returns based on net cash proceeds received by the Company upon the sale, merger or other exit transaction of certain identified partner companies. Vesting may occur, if at all, once per year. The requisite service periods for the performance-based awards are based on the Company s estimate of when the performance conditions will be met. Compensation expense is recognized for performance-based awards for which the performance condition is considered probable of achievement. Compensation expense is recognized over the requisite service periods using the straight-line method but is accelerated if capital return targets are achieved earlier than estimated. During the years ended December 31, 2011, 2010 and 2009, respectively, the Company issued 193 thousand, 130 thousand and 155 thousand performance-based option awards to employees. During the year ended December 31, 2011, 56 thousand options vested based on the achievement of capital return targets. During the years ended December 31, 2010 and 2009, no options vested based on the achievement of capital returns targets. During the years ended December 31, 2011 and 2010, respectively, 108 thousand and six thousand performance-based option awards were canceled or forfeited. The Company recorded compensation expense related to these option awards of $0.3 million, $0.1 million and $0.1 million for the years ended December 31, 2011, 2010 and 2009, respectively. The maximum number of unvested shares at December 31, 2011 attainable under these grants was 648 thousand shares.

All other outstanding options are service-based awards that generally vest over four years after the date of grant and expire eight years after the date of grant. Compensation expense is recognized over the requisite service period using the straight-line method. The requisite service period for service-based awards is the period over which the award vests. During the years ended December 31, 2011, 2010 and 2009, respectively, the Company issued 121 thousand, 95 thousand and 113 thousand service-based option awards to employees. During the years ended December 31, 2011, 2010 and 2009, respectively, 60 thousand, nine thousand and 231 thousand service-based options were canceled or forfeited. The Company recorded compensation expense related to these awards of $0.8 million, $1.2 million and $1.0 million during the years ended December 31, 2011, 2010 and 2009, respectively.

The fair value of the Company s stock-based awards to employees was estimated at the date of grant using the Black-Scholes option-pricing model. The risk-free rate is based on the U.S. Treasury yield curve in effect at the end of the quarter in which the grant occurred. The expected term of stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility measured using weekly price observations of the Company s common stock for a period equal to the stock option s expected term. Assumptions used in the valuation of options granted in each period were as follows:

	Year Ended December 31,		
	2011	**2010**	**2009**
Service-Based Awards			
Dividend yield	0%	0%	0%
Expected volatility	57%	58%	59%
Average expected option life	5 years	5 years	5 years
Risk-free interest rate	1.4%	2.0%	2.7%

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Year Ended December 31,		
	2011	**2010**	**2009**
Performance-Based Awards			
Dividend yield	0%	0%	0%
Expected volatility	57%	58%	59%
Average expected option life	5.8 years	4.9 years	4.9 years
Risk-free interest rate	0.9%	2.0%	2.7%

The weighted-average grant date fair value of options issued by the Company during the years ended December 31, 2011, 2010 and 2009 was $8.28, $7.42 and $5.22 per share, respectively.

Option activity of the Company is summarized below:

	Shares (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2008	3,336	$ 10.05		
Options granted	267	9.99		
Options exercised	(34)	7.77		
Options canceled/forfeited	(301)	16.21		
Outstanding at December 31, 2009	3,268	9.51		
Options granted	224	14.65		
Options exercised	(121)	9.16		
Options canceled/forfeited	(50)	12.13		
Outstanding at December 31, 2010	3,321	9.83		
Options granted	314	16.55		
Options exercised	(124)	11.32		
Options canceled/forfeited	(293)	11.03		
Outstanding at December 31, 2011	3,218	10.32	3.9	$ 17,480
Options exercisable at December 31, 2011	1,403	9.65	2.8	8,379
Options vested and expected to vest at December 31, 2011	2,720	10.03	3.4	15,454
Shares available for future grant	680			

The total intrinsic value of options exercised for the years ended December 31, 2011, 2010 and 2009 was $0.9 million, $0.4 million and $0.1 million, respectively.

At December 31, 2011, total unrecognized compensation cost related to non-vested stock options granted under the plans for service-based awards was $0.8 million. That cost is expected to be recognized over a weighted-average period of 2.5 years.

At December 31, 2011, total unrecognized compensation cost related to non-vested stock options granted under the plans for market-based awards was $0.4 million. That cost is expected to be recognized over a weighted-average period of 1.6 years, but would be accelerated if market capitalization targets are achieved earlier than estimated.

At December 31, 2011, total unrecognized compensation cost related to non-vested stock options granted under the plans for performance-based awards was $2.5 million. That cost is expected to be recognized over a weighted-average period of 2.0 years but would be accelerated if stock price targets are achieved earlier than estimated.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the years ended December 31, 2011, 2010 and 2009, respectively, the Company issued 61 thousand, 74 thousand and 103 thousand performance-based stock units to employees which vest based on achievement by the Company of target capital returns based on net cash proceeds received by the Company on the sale, merger or other exit transaction of certain identified partner companies, as described above related to performance-based option awards. Performance-based stock units represent the right to receive shares of the Company s common stock, on a one-for-one basis. During the years ended December 31, 2011, 2010 and 2009, respectively, the Company issued 20 thousand, 25 thousand and 197 thousand restricted shares to employees. The restricted shares issued vest 25% on the first anniversary of grant and the remaining 75% thereafter in equal monthly installments over the next two or three years, as applicable. During the year ended December 31, 2010, the Company issued 53 thousand unrestricted shares to employees in connection with the 2009 management incentive plan payments earned by certain senior employees.

The Company issued deferred stock units during the years ended December 31, 2011, 2010 and 2009, to all non-employee directors as annual service grants and to directors who deferred all or a portion of directors fees earned. Deferred stock units issued to directors in lieu of directors fees are 100% vested at the grant date; matching deferred stock units equal to 25% of directors fees deferred generally vest one year following the grant date. Deferred stock units represent the right to receive shares of the Company s common stock, on a one-for-one basis, following termination of employment or service, death or permanent disability. During the years ended December 31, 2011, 2010 and 2009, respectively, the Company issued 28 thousand, 32 thousand and 70 thousand deferred stock units to directors.

During the years ended December 31, 2010, and 2009, respectively, the Company granted two thousand restricted shares and 12 thousand stock options to members of its advisory boards, which comprise non-employees. Such awards generally vest within one year following grant.

Total compensation expense for deferred stock units, performance-based stock units and restricted stock was approximately $0.7 million, $0.8 million and $0.4 million for the years ended December 31, 2011, 2010 and 2009, respectively. Unrecognized compensation expense related to deferred stock units, performance stock units and restricted stock at December 31, 2011 was $2.5 million. The total fair value of deferred stock units, performance stock units and restricted stock vested during the years ended December 31, 2011, 2010 and 2009 was $2.0 million, $1.8 million and $0.5 million, respectively.

Deferred stock unit, performance-based stock unit and restricted stock activity is summarized below:

	Shares (In thousands)	Weighted Average Grant Date Fair Value
Unvested at December 31, 2009	317	$ 5.95
Granted	133	14.80
Vested	(147)	5.80
Forfeited	(5)	7.73
Unvested at December 31, 2010	298	10.09
Granted	109	15.93
Vested	(116)	8.16
Forfeited	(38)	12.73
Unvested at December 31, 2011	253	13.10

Stock based compensation expense for Clarient prior to its deconsolidation was included in the Company s consolidated results of operations. During the period from January 1, 2009 through May 14, 2009, the Company recognized stock-based compensation related to Clarient of $0.8 million.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Other Income (Loss), Net

	Year Ended December 31, 2011	2010	2009
		(In thousands)	
Loss on exchange of convertible debentures	$	$ (8,289)	$
Gain on repurchase of convertible debentures, net			457
Gain (loss) on sale of companies and funds, net		20,291	(7,338)
Gain on distributions from private equity funds			30
Gain on deconsolidation of Clarient			105,991
Gain on sale of Clarient		42,956	
Gain on mark-to-market of holdings in Clarient		22,394	19,502
Impairment charges on cost method partner companies		(2,146)	(10,079)
Other than temporary impairment on available-for-sale securities	(7,451)	(1,108)	
Other	1,306	711	318
	$ (6,145)	$ 74,809	$ 108,881

12. Income Taxes

The provision (benefit) for income taxes was as follows:

	Year Ended December 31, 2011	2010	2009
		(In thousands)	
Current, primarily state	$	$	$ (14)
Deferred, primarily state			
	$	$	$ (14)

The total income tax provision (benefit) differed from the amounts computed by applying the U.S. federal income tax rate of 35% to net income (loss) from continuing operations before income taxes as a result of the following:

	Year Ended December 31, 2011	2010	2009
Statutory tax expense	35.0%	35.0%	35.0%
Increase (decrease) in taxes resulting from:			
Valuation allowance	(35.3)	(36.7)	(35.2)
Other adjustments	0.3	1.7	0.2
	0.0%	0.0%	0.0%

72

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities were as follows:

	2011	2010
	(In thousands)	
Deferred tax asset (liability):		
Carrying values of partner companies and other holdings	$ 50,041	$ 54,821
Tax loss and credit carryforwards	59,626	97,161
Accrued expenses	1,838	1,928
Stock-based compensation	7,580	6,405
Other	1,047	1,244
	120,132	161,559
Valuation allowance	(120,132)	(161,559)
Net deferred tax liability	$	$

As of December 31, 2011, the Company and its subsidiaries consolidated for tax purposes had federal net operating loss carryforwards of approximately $159.2 million. These carryforwards expire as follows:

	(In thousands)
2012	$
2013	
2014	
2015	
2016 and thereafter	159,229
	$ 159,229

Limitations on utilization of the net operating loss carryforwards may apply.

In assessing the recoverability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company has determined that it is more likely than not that certain future tax benefits may not be realized as a result of current and future income. Accordingly, a valuation allowance has been recorded against substantially all of the Company s deferred tax assets.

The Company recognizes in its Consolidated Financial Statements the impact of a tax position if that position is more likely than not to be sustained upon examination, based on the technical merits of the position. All uncertain tax positions relate to unrecognized tax benefits that would impact the effective tax rate when recognized.

The Company does not expect any material increase or decrease in its income tax expense, in the next twelve months, related to examinations or changes in uncertain tax positions.

Changes in the Company s uncertain tax positions for the years ended December 31, 2011, 2010 and 2009 were as follows:

	Year Ended December 31,		
	2011	2010	2009
		(In thousands)	
Balance at beginning of year	$	$	$ 14
Settlements/lapses in statutes of limitation			(14)
Balance at end of year	$	$	$

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company files income tax returns in the U.S. federal jurisdiction, and various state jurisdictions. Tax years 2008 and forward remain open for examination for federal tax purposes and tax years 2006 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 December 31, 2011 will remain subject to examination until the respective tax year is closed. 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.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Net Income Per Share

The calculations of net income per share were:

	Year Ended December 31,		
	2011	2010	2009
	(In thousands except per share data)		
Basic:			
Amounts attributable to Safeguard Scientifics, Inc. common shareholders:			
Net income from continuing operations	$ 110,597	$ 26,609	$ 66,240
Net income from discontinued operations			1,370
Net income attributable to Safeguard Scientifics, Inc.	$ 110,597	$ 26,609	$ 67,610
Average common shares outstanding	20,764	20,535	20,308
Net income per share from continuing operations attributable to Safeguard Scientifics, Inc. common shareholders	$ 5.33	$ 1.30	$ 3.26
Net income per share from discontinued operations attributable to Safeguard Scientifics, Inc. common shareholders			0.07
Net income per share attributable to Safeguard Scientifics Inc. common shareholds	$ 5.33	$ 1.30	$ 3.33
Diluted:			
Amounts attributable to Safeguard Scientifics, Inc. common shareholders:			
Net income from continuing operations	$ 110,597	$ 26,609	$ 66,240
Interest on covertible senior debentures	5,750		2,616
Net income from continuing operations for diluted per share computation	116,347	26,609	68,856
Net income from discontinued operations			1,370
Net income for diluted per share calculation	$ 116,347	$ 26,609	$ 70,226
Number of shares used in basic per share computation	20,764	20,535	20,308
Effect of dilutive securities:			
Convertible senior debentures	3,009		1,956
Unvested restricted stock and DSUs	60	115	111
Employee stock options	689	857	8
Number of shares used in diluted per share computation	24,522	21,507	22,383
Net income per share from continuing operations attributable to Safeguard Scientifics, Inc. common shareholders	$ 4.74	$ 1.24	$ 3.08
Net income per share from discontinued operations attributable to Safeguard Scientifics, Inc. common shareholders			0.06
Net income per share attributable to Safeguard Scientifics Inc. common shareholders	$ 4.74	$ 1.24	$ 3.14

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).

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

At December 31, 2011, 2010 and 2009, options to purchase 0.1 million, 0.6 million and 2.7 million shares of common stock, respectively, at prices ranging from $18.78 to $21.36 per share, $10.10 to $21.36 per share, and $7.50 to $21.36 per share were excluded from the calculation.

At December 31, 2010 and 2009, unvested restricted stock units, performance stock units and DSUs convertible into 2 thousand and 6 thousand shares of stock, respectively, were excluded from the calculations.

At December 31, 2011, 2010 and 2009 a total of 0.0 million, 0.7 million and 0.0 million related to the Company s 2024 Debentures representing the effect of assumed conversion of the 2024 Debentures were excluded from the calculation.

At December 31, 2011 and 2010, a total of 0.0 million and 2.8 million shares related to the Company s 2014 Debentures representing the effect of assumed conversion of the 2014 Debentures were excluded from the calculations.

14. Related Party Transactions

In May 2001, the Company entered into a $26.5 million loan agreement with Warren V. Musser, the Company s former Chairman and Chief Executive Officer. Through December 31, 2011, the Company recognized impairment charges against the loan of $15.7 million. The Company s 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 December 31, 2011, the Company has received a total of $16.9 million in payments on the loan. In December 2011, the loan documents were amended to take into account accumulated unpaid interest and to make certain other changes related to collateral, maturity dates and other terms. The Company received cash from the sale of collateral in 2011 in the amount of $0.1 million and no payments in 2010. The carrying value of the loan at December 31, 2011 was zero.

In the normal course of business, the Company s directors, officers and employees hold board positions of companies in which the Company has a direct or indirect ownership interest.

15. Commitments and Contingencies

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

The Company leases its corporate headquarters and office equipment under leases expiring at various dates to 2016. Total rental expense under operating leases was $0.5 million, $0.5 million and $0.8 million in 2011, 2010 and 2009, respectively. Rent expense includes amounts attributed to Clarient prior to its deconsolidation. Future minimum lease payments under non-cancelable operating leases with initial or remaining terms of

one year or more at December 31, 2011, are (in millions): $0.5 2012; $0.5 2013; $0.5 2014; $0.0 2015; and $0.0 thereafter.

76

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Not including the Laureate Pharma, Inc. lease guaranty described below, the Company had outstanding guarantees of $3.8 million at December 31, 2011 related to the Company s general partner interest in a private equity fund.

The Company has committed capital of approximately $0.2 million to various private equity funds. These commitments will be funded during the next 12 months.

Under certain circumstances, the Company may be required to return a portion or all of the distributions it received as a general partner of certain private equity funds (clawback). The maximum clawback the Company could be required to return due to our general partner interest is approximately $1.3 million, of which $1.0 million was reflected in Accrued expenses and other current liabilities and $0.3 million was reflected in other long-term liabilities on the Consolidated Balance Sheet at December 31, 2011. In the fourth quarter of 2011, the Company released $1.0 million from accrued expenses due to the expiration of a contingency period in accordance with the terms of the respective partnership agreement.

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

As described in Note 2, in connection with the Bundle Transaction, an aggregate of $6.4 million of the gross proceeds of the sale were placed in escrow pending the expiration of a predetermined notification period, subject to possible extension in the event of a claim against the escrowed amounts. On April 25, 2009, the purchaser in the Bundle Transaction notified the Company of claims being asserted against the entire escrowed amounts. The Company does not believe that such claims are valid and has instituted legal action to obtain the release of such amounts from escrow. The proceeds being held in escrow will remain there until the dispute over the claims has been settled or determined pursuant to legal process.

The Company remains guarantor of Laureate Pharma, Inc. s Princeton, New Jersey facility lease (the Laureate Lease Guaranty). Such guarantee may extend through the lease expiration in 2016 under certain circumstances. However, the Company is entitled to indemnification in connection with the continuation of such guaranty. As of December 31, 2011, scheduled lease payments to be made by Laureate Pharma Inc. over the remaining lease term equaled $6.0 million.

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

In October 2001, the Company entered into an agreement with its former Chairman and Chief Executive Officer, to provide for annual payments of $650,000 per year and certain health care and other benefits for life. The related current liability of $0.8 million was included in Accrued expenses and the long-term portion of $3.0 million was included in Other long-term liabilities on the Consolidated Balance Sheet at December 31, 2011.

The Company has agreements with certain employees that provide for severance payments to the employee in the event the employee is terminated without cause or an employee terminates his employment for good reason. The maximum aggregate exposure under the agreements was approximately $8 million at December 31, 2011.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. 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 partner companies (see Note 1) were accounted for under the equity method of accounting for all periods presented during which the Company owned its interest in these companies. Given no partner companies were consolidated during the years ended December 31, 2011 and 2010 only the Statements of Operations and Cash Flows for the year ended December 31, 2009 are presented below.

Parent Company Statements of Operations

	2009 (In thousands)
Operating expenses	$ (17,807)
Other income (loss), net	108,881
Interest income	476
Interest expense	(2,889)
Equity loss	(22,435)
Net income from continuing operations before income taxes	66,226
Income tax benefit	14
Equity income attributable to discontinued operations	1,370
Net income	$ 67,610

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Parent Company Statements of Cash Flows

	2009
Cash Flows from Operating Activities:	
Net income (loss)	$ 67,610
Adjustments to reconcile to net cash used in operating activities:	
Equity (income) loss from discontinued operations	(1,370)
Depreciation	130
Equity loss	22,435
Non-cash compensation charges	2,982
Other income (loss), net	(108,881)
Changes in assets and liabilities, net of effect of acquisitions and dispositions	2,412
Net cash used in operating activities	(14,682)
Cash Flows from Investing Activities	
Proceeds from sales of and distributions from companies and funds	61,302
Advances to partner companies	(7,150)
Repayments of advances to partner companies	21,179
Acquisitions of ownership interests in partner companies and funds, net of cash acquired	(35,939)
Increase in marketable securities	(73,187)
Decrease in marketable securities	48,822
Decrease in restricted cash	861
Capital expenditures	(27)
Net cash provided by investing activities	15,861
Cash Flows from Financing Activities:	
Repurchase of convertible senior debentures	(7,271)
Issuance of Company common stock, net	270
Repurchase of Company common stock	(44)
Net cash used in financing activities	(7,045)
Net Decrease in Cash and Cash Equivalents	(5,866)
Cash and Cash Equivalents at beginning of period	73,213
Cash and Cash Equivalents at end of period	$ 67,347

17. Supplemental Cash Flow Information

During the years ended December 31, 2011, 2010 and 2009, the Company converted $0.0 million, $2.7 million and $0.4 million, respectively, of advances to partner companies into ownership interests in partner companies.

Cash payments for interest in the years ended December 31, 2011, 2010 and 2009 were $0.4 million, $1.5 million and $1.4 million, respectively. In addition, during the years ended December 31, 2011 and 2010, interest payments of $4.8 million and $2.2 million, respectively, on the 2014 Debentures were made using restricted cash equivalents. During the year ended December 31, 2009, interest payments on the 2024 Debentures of $1.1 million were made using restricted marketable securities.

As discussed in Note 7, during the year ended December 31, 2010, the Company completed a non-cash exchange of $46.9 million in face value of its 2024 Debentures for the same amount in face value of its newly issued 2014 Debentures.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash paid for taxes in the years ended December 31, 2011, 2010 and 2009 was $0.0 million in each year.

18. Operating Segments

In August 2011, the Company acquired a 36% ownership interest in the management company and general partner of Penn Mezzanine for $3.9 million (see Note 4). In the fourth quarter of 2011, the Company funded an aggregate of $9.7 million for participations in certain mezzanine loans and equity interests initiated by Penn Mezzanine. As a result of the capital deployed in 2011, the Company began to separately evaluate the results of Penn Mezzanine. The Company re-evaluated its reportable segments and made the determination that Penn Mezzanine would be reported as a reportable segment.

As of December 31, 2011, the Company held an interest in 15 non-consolidated partner companies. The Company s reportable operating segments are Life Sciences, Technology and Penn Mezzanine.

The Company s active partner companies as of December 31, 2011 by segment were as follows for the years ended December 31, 2011, 2010 and 2009:

Life Sciences

Partner Company	Safeguard Primary Ownership as of December 31 2011	2010	2009	Accounting Method
Alverix, Inc.	49.6%	49.6%	49.6%	Equity
Good Start Genetics, Inc.	26.3%	26.3%	NA	Equity
Medivo, Inc.	30.0%	NA	NA	Equity
NovaSom, Inc.	30.3%	NA	NA	Equity
NuPathe, Inc.	17.8%	18.1%	22.9%	Available-for-sale (1)
PixelOptics, Inc.	24.7%	NA	NA	Equity
Putney, Inc.	27.6%	NA	NA	Equity

(1) The Company s ownership interest in NuPathe is accounted for as available-for-sale securities following NuPathe s completion of an initial public offering in August 2010. The Company previously accounted for NuPathe under the equity method.

Technology

Partner Company	Safeguard Primary Ownership as of December 31 2011	2010	2009	Accounting Method
AdvantEdge Healthcare Solutions, Inc.	40.2%	40.2%	39.7%	Equity
Beyond.com Inc.	38.3%	38.3%	38.3%	Equity
Bridgevine, Inc.	22.8%	22.8%	23.6%	Equity
Crimson Informatics, Inc.	23.9%	NA	NA	Equity

Hoopla Software, Inc.	28.0%	NA	NA	Equity
MediaMath, Inc.	22.4%	17.3%	17.5%	Equity (1)
Swap.com (formerly Swaptree, Inc.)	45.6%	45.6%	29.3%	Equity
ThingWorx	30.2%	NA	NA	Equity

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

As of December 31, 2011, the Penn Mezzanine segment has a 36% ownership interest in the management company and general partner of Penn Mezzanine L.P. The Company accounts for its interest under the equity method.

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

Management evaluates its Life Sciences and Technology segments performance based on net loss which is based on the number of partner companies accounted for under the equity method, the Company s voting ownership percentage in these partner companies and the net results of operations of these partner companies and any impairment charges or gain (loss) on sale of partner companies. Management evaluates the Penn Mezzanine segment performance based on the performance of the mezzanine interests in which the Company participates. This includes an evaluation of the future cash flows associated with interest and dividend payments as well as estimated losses based on evaluating known and inherent risks in the investments in which the Company participates.

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

Prior to its sale in December 2010, Clarient was included in the Life Sciences segment for all periods presented. As of May 14, 2009 the Company accounted for its interest in Clarient under the fair value method. Prior to May 14, 2009, Clarient was consolidated.

Revenue related entirely to Clarient prior to its deconsolidation and was attributed to geographic areas based on where the services were performed or the customer s shipped to location. A majority of the Company s revenue was generated in the United States.

As of December 31, 2011 and 2010, the Company s assets were located in the United States.

Segment assets in Other items included primarily cash, cash equivalents, cash held in escrow and marketable securities of $264.0 million and $232.3 million at December 31, 2011 and 2010, respectively, excluding discontinued operations.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following represents segment data from continuing operations:

	For the Year Ended December 31, 2011					
	Life Sciences	Technology	Penn Mezzanine	Total Segments	Other Items	Total Continuing Operations
	(In thousands)					
Revenue	$	$	$	$	$	$
Operating loss					(21,168)	(21,168)
Interest income			210	210	1,214	1,424
Equity income (loss)	122,289	20,464	(71)	142,682	(225)	142,457
Net income (loss) from continuing operations	115,053	20,488	139	135,680	(25,083)	110,597
Segment Assets:						
December 31, 2011	64,281	46,304	12,965	123,550	283,086	406,636

	For the Year Ended December 31, 2010				
	Life Sciences	Technology	Total Segments	Other Items	Total Continuing Operations
	(In thousands)				
Revenue	$	$	$	$	$
Operating loss				(20,847)	(20,847)
Equity loss	(11,786)	(10,544)	(22,330)	(4)	(22,334)
Net income (loss) from continuing operations	70,658	(10,508)	60,150	(33,541)	26,609
Segment Assets:					
December 31, 2010	37,710	42,820	80,530	256,015	336,545

	For the Year Ended December 31, 2009				
	Life Sciences	Technology	Total Segments	Other Items	Total Continuing Operations
	(In thousands)				
Revenue	$ 34,839	$	$ 34,839	$	$ 34,839
Operating income (loss)	1,621		1,621	(17,807)	(16,186)
Equity loss	(16,283)	(6,896)	(23,179)	(48)	(23,227)
Net income (loss) from continuing operations	99,289	(12,742)	86,547	(19,749)	66,798

Net loss from continuing operations from Other Items was as follows:

	Year Ended December 31,		
	2011	2010	2009
	(In thousands)		
Corporate operations	$ (25,083)	$ (33,541)	$ (19,763)

Income tax benefit			14
	$ (25,083)	$ (33,541)	$ (19,749)

82

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. Selected Quarterly Financial Information (Unaudited)

	Three Months Ended			
	March 31	June 30	September 30	December 31
	(In thousands except per share data)			
2011:				
General and administrative expense	$ 4,884	$ 5,570	$ 5,100	$ 5,614
Operating loss	(4,884)	(5,570)	(5,100)	(5,614)
Other income (loss), net	(292)	(775)	(324)	(4,754)
Interest income	367	324	278	455
Interest expense	(1,636)	(1,441)	(1,445)	(1,449)
Equity income (loss)	(2,565)	129,277	28,922	(13,177)
Net income (loss) before income taxes	(9,010)	121,815	22,331	(24,539)
Income tax benefit				
Net income (loss)	$ (9,010)	$ 121,815	$ 22,331	$ (24,539)
Net income (loss) per share (a)				
Basic	$ (0.44)	$ 5.87	$ 1.07	$ (1.18)
Diluted	$ (0.46)	$ 5.05	$ 0.98	$ (1.18)
2010:				
General and administrative expense	$ 4,833	$ 4,910	$ 4,256	$ 6,848
Operating loss	(4,833)	(4,910)	(4,256)	(6,848)
Other income (loss), net	(11,297)	14,408	8,144	63,554
Interest income	97	239	180	202
Interest expense	(730)	(1,657)	(1,674)	(1,676)
Equity loss	(5,088)	(5,357)	(1,798)	(10,091)
Net income (loss) before income taxes	(21,851)	2,723	596	45,141
Income tax benefit				
Net income (loss)	$ (21,851)	$ 2,723	$ 596	$ 45,141
Net income (loss) per share (a)				
Basic	$ (1.07)	$ 0.13	$ 0.03	$ 2.19
Diluted	$ (1.07)	$ 0.12	$ 0.03	$ 1.83

(a) Per share amounts for the quarters have each been calculated separately. Accordingly, quarterly amounts may not add to the annual amounts because of differences in the average common shares outstanding during each period. Additionally, in regard to diluted per share amounts only, quarterly amounts may not add to the annual amounts because of the inclusion of the effect of potentially dilutive securities only in the periods in which such effect would have been dilutive, and because of the adjustments to net income (loss) for the dilutive effect of partner company common stock equivalents and convertible securities.

Table of Contents

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

20. CHANGE IN ACCOUNTING PRINCIPLE

During first quarter of 2011, the Company increased its ownership interest in MediaMath to 22.4%, above the threshold at which the Company believes it exercises significant influence. Accordingly, the Company adopted the equity method of accounting for its holdings in MediaMath. The Company has adjusted the financial statements for prior periods contained in this Annual Report on Form 10-K to retrospectively apply the equity method of accounting for its holdings in MediaMath since the initial date of acquisition in July 2009. The effect of the change was to decrease Ownership interests in and advances to partner companies and funds by $0.5 million as of December 31, 2010 and to increase Equity loss by $0.5 million for the year ended December 31, 2010. Equity loss for the year ended December 31, 2009 and Equity as of December 31, 2009 were unaffected by this change.

	December 31, 2010 (in thousands)	
	Previously Reported	As Revised
Balance Sheet:		
Ownership interests in and advances to partner companies	$ 60,761	$ 60,256
Total Assets	337,050	336,545
Accumulated deficit	(574,802)	(575,307)
Equity	246,936	246,431

	Year Ended December 31, 2010 (In thousands except	
	Previously Reported	As Revised
Statement of Operations:		
Equity loss	$ (21,829)	$ (22,334)
Net income before income taxes	27,114	26,609
Basic income per share	1.32	1.30
Diluted income per share	1.26	1.24

Table of Contents

Item 9. ***Changes in and Disagreements With Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

(a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act), that are designed to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. 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 December 31, 2011. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of December 31, 2011 are functioning effectively.

Our business strategy involves the acquisition of new businesses on an ongoing basis, most of which are young, growing companies. Typically, these companies historically have not 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.

(b) Management s Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2011. In making this assessment, management used the framework established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As a result of this assessment and based on the criteria in the COSO framework, management has concluded that, as of December 31, 2011, the Company s internal control over financial reporting was effective.

Our independent registered public accounting firm, KPMG LLP, has audited the effectiveness of our internal control over financial reporting as of December 31, 2011. Their opinion on the effectiveness of our internal control over financial reporting and their opinion on our Consolidated Financial Statements are included in Item 8 in this Form 10-K.

Table of Contents

(c) Change in Internal Control over Financial Reporting

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

Item 9B. ***Other Information***

None

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***

Incorporated by reference to the portion of our Definitive Proxy Statement entitled Election of Directors, Corporate Governance and Board Matters and Section 16(a) Beneficial Ownership Reporting Compliance. Information about our Executive Officers is included in Annex to Part I above.

Item 11. ***Executive Compensation***

Incorporated by reference to the portions of our Definitive Proxy Statement entitled Compensation Discussion and Analysis, Compensation Committee Report and Executive Compensation.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Incorporated by reference to the portion of our Definitive Proxy Statement entitled Stock Ownership of Certain Beneficial Owners, Directors and Officers.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

Our equity compensation plans provide a broad-based program designed to attract and retain talent while creating alignment with the long-term interests of our shareholders. Employees at all levels participate in our equity compensation plans. In addition, members of our Board of Directors (Board) and members of our Technology and Life Sciences Advisory Boards (Advisory Boards) receive equity grants for their service on our Board and Advisory Boards, respectively. Members of our Board also receive deferred stock unit awards and are eligible to defer directors fees and receive deferred stock units with a value equal to the directors fees deferred and matching deferred stock units equal to 25% of the directors fees deferred.

The 2001 Associates Equity Compensation Plan (2001 Plan) provided for the grant of nonqualified stock options, stock appreciation rights, restricted stock, performance units, and other stock-based awards to employees, consultants or advisors of Safeguard and its subsidiaries, provided that no grants could be made under this plan to executive officers or directors of Safeguard. Under the NYSE rules that were in effect at the time this plan was adopted in 2001, shareholder approval of the plan was not required. Except for the persons eligible to participate in the 2001 Plan and the inability to grant incentive stock options under the 2001 Plan, the terms of the 2001 plan are substantially the same as the other equity compensation plans approved by our shareholders (which have been described in previous filings).

A total of 900,000 shares of our common stock were authorized for issuance under the 2001 Plan. At December 31, 2011, 384,858 shares were subject to outstanding options and performance stock units, no shares were available for future issuance, and 389,983 shares had been issued under the 2001 Plan. The 2001 Plan expired by its terms on February 21, 2011. Equity grants previously awarded under this plan that have not yet expired or otherwise become unexercisable continue to be administered in accordance with the terms of the grants. Any portions of outstanding equity grants under the 2001 Plan that expire or become unexercisable for any reason shall be cancelled and shall be unavailable for future issuance.

During 2005, 2007, 2008 and 2011, the Compensation Committee granted employee inducement awards to five newly hired officers. The awards were granted outside of Safeguard s existing equity compensation plans in accordance with NYSE rules and consisted of options to purchase up to an aggregate of 1,501,665 shares of

Table of Contents

Safeguard common stock. All of these employee inducement awards were granted with a per share exercise price equal to the average of the high and low prices of Safeguard common stock on the grant date, 1,437,915 of such awards were granted with an eight-year term and 63,750 of such awards were granted with a 10-year term. Of the shares underlying the employee inducement awards that were outstanding at December 31, 2011, 375,415 shares are subject to time-based vesting, with an aggregate of 93,854 shares vesting on the first anniversary of the grant date and 281,561 shares vesting in 36 equal monthly installments thereafter. Of the remaining shares underlying the employee inducement awards that were outstanding at December 31, 2011, 1,062,500 vest incrementally based upon the achievement of certain specified levels of increase in Safeguard s stock price and 63,750 vest based on the aggregate cash produced as a result of exit transactions involving certain of our partner companies relative to the amount of cash deployed in connection with such partner companies. With the exception of the market-based vesting or performance-based vesting provisions, the terms and provisions of the employee inducement awards are substantially the same as options previously awarded to other officers under Safeguard s equity compensation plans.

The following table provides information as of December 31, 2011 about the securities authorized for issuance under our equity compensation plans. The material features of our equity compensation plans are described in Note 10 to the Consolidated Financial Statements filed as part of our Annual Report on Form 10-K for the year ended December 31, 2011.

Equity Compensation Plan Information

Plan Category	**Number of Securities to Be Issued Upon Exercise of Outstanding Options, Warrants and Rights (1) (a)**	**Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (2) (b)**	**Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)**
Equity compensation plans approved by security holders (3)	1,698,747	$ 11.091	680,275
Equity compensation plans not approved by security holders (4)	1,886,524	$ 9.730	
Total	3,585,271	$ 10.316	680,275

(1) Includes a total of 284,966 shares underlying performance stock units and deferred stock units awarded for no consideration and 81,871 shares underlying deferred stock units awarded to directors in lieu of all or a portion of directors fees.

(2) The weighted average exercise price calculation excludes 366,837 shares underlying outstanding deferred stock units and performance stock units included in column (a) which are payable in stock, on a one-for-one basis.

(3) Represents awards granted under the 1999 Equity Compensation Plan and the 2004 Equity Compensation Plan and shares available for issuance under the 2004 Equity Compensation Plan.

(4) Includes awards granted under the 2001 Plan and 1,501,665 employee inducement awards.

Item 13. ***Certain Relationships and Related Transactions, and Director Independence***

Incorporated by reference to the portions of the Definitive Proxy Statement entitled Corporate Governance Principles and Board Matters Board Independence and Review and Approval of Transactions with Related Persons and Relationships and Transactions with Management and

Others.

Item 14. ***Principal Accountant Fees and Services***

Incorporated by reference to the portion of the Definitive Proxy Statement entitled Independent Public Accountant Audit Fees.

Table of Contents

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***
(a) Consolidated Financial Statements and Schedules

Incorporated by reference to Item 8 of this Report on Form 10-K.

(b) Exhibits

The exhibits required to be filed as part of this Report are listed in the exhibit index below.

(c) Financial Statement Schedules

The separate consolidated financial statements of Clarient, Inc. as of December 31, 2009 and for the year ended December 31, 2009 required to be included in this report pursuant to Rule 3-09 of Regulation S-X, are filed as Exhibit 99.1.

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 footnotes to this table.

Exhibit Number	Description	Incorporated Filing Reference Form Type & Filing Date	Original Exhibit Number
2.1.1	Purchase Agreement, dated as of February 29, 2008, by and between Safeguard Scientifics, Inc., as Seller, and Saints Capital Dakota, L.P., as Purchaser.	Form 8-K 3/4/08	2.1
2.1.2	First Amendment to Purchase Agreement, dated May 6, 2008, by and between Safeguard Scientifics, Inc., as Seller, and Saints Capital Dakota, L.P., as Purchaser	Form 8-K 5/7/08	2.1
3.1.1	Seconded Amended and Restated Articles of Incorporation of Safeguard Scientifics, Inc.	Form 8-K 10/25/07	3.1
3.1.2	Amendment to Seconded Amended and Restated Articles of Incorporation of Safeguard Scientifics, Inc.	Form 8-K 8/27/09	3.1
3.1.3	Statement with Respect to Shares	Registration Statement on Form S-4 12/17/10	3.1.3
3.2	Amended and Restated By-laws of Safeguard Scientifics, Inc.	Form 8-K 10/25/07	3.2
4.1	Indenture, dated as of February 18, 2004, between Safeguard Scientifics, Inc. and Wachovia Bank, National Association, as trustee, including the form of 2.625% Convertible Senior Debentures due 2024	Form 10-K 3/15/04	4.10

4.2	Indenture, dated as of March 26, 2010, by and between Safeguard Scientifics, Inc. and U.S. Bank, National Association	Form 8-K 3/30/10	4.1
4.3	Global Note representing 10.125% Convertible Senior Debentures due March 15, 2014	Form 8-K 3/30/10	4.2

Table of Contents

Exhibit Number	Description	Incorporated Filing Reference Form Type & Filing Date	Original Exhibit Number
4.4	Escrow Agreement, dated as of March 26, 2010, by and among Safeguard Scientifics, Inc., U.S. Bank, National Association (as trustee) and U.S. Bank, National Association (in its capacity as escrow agent)	Form 8-K 3/30/10	4.3
10.1*	Safeguard Scientifics, Inc. 1999 Equity Compensation Plan, as amended and restated on October 21, 2008	Form 10-Q 11/6/08	10.4
10.2	Safeguard Scientifics, Inc. 2001 Associates Equity Compensation Plan, as amended and restated on October 21, 2008	Form 10-Q 11/6/08	10.5
10.3*	Safeguard Scientifics, Inc. 2004 Equity Compensation Plan, as amended and restated on July 13, 2009 (attached to the Company s Definitive Proxy Statement filed on July 23, 2009)	Form 10-K 3/16/10	10.3
10.4*	Safeguard Scientifics, Inc. Executive Deferred Compensation Plan (amended and restated as of January 1, 2009)	Form 10-K 3/19/09	10.4
10.5*	Management Incentive Plan	Form 8-K 4/25/08	10.1
10.6*	Compensation Summary Non-employee Directors	Form 10-Q 7/30/10	10.1
10.7.1*	Amended and Restated Agreement by and between Safeguard Scientifics, Inc. and Peter J. Boni dated December 5, 2008	Form 10-K 3/19/09	10.7
10.7.2*	Compensation Agreement by and between Safeguard Scientifics, Inc. and Peter J. Boni dated December 14, 2009	Form 10-K 3/16/10	10.7.2
10.8.1*	Amended and Restated Agreement by and between Safeguard Scientifics, Inc. and James A. Datin dated December 31, 2008	Form 10-K 3/19/09	10.8
10.8.2*	Compensation Agreement by and between Safeguard Scientifics, Inc. and James A. Datin dated December 14, 2009	Form 10-K 3/16/10	10.8.2
10.9.1*	Agreement by and between Safeguard Scientifics, Inc. and Stephen Zarrilli dated as of May 28, 2008	Form 8-K 5/29/08	10.1
10.9.2*	Letter Amendment dated December 9, 2008, to Agreement by and between Safeguard Scientifics, Inc. and Stephen Zarrilli dated as of May 28, 2008	Form 10-K 3/19/09	10.9.2
10.10.1*	Agreement by and between Safeguard Scientifics, Inc. and Kevin L. Kemmerer dated December 29, 2008	Form 10-K 3/19/09	10.11
10.10.2*	Compensation Agreement by and between Safeguard Scientifics, Inc. and Kevin L. Kemmerer dated December 14, 2009	Form 10-K 3/16/10	10.10.2
10.11.1*	Amended and Restated Letter Agreement by and between Safeguard Scientifics, Inc. and Brian J. Sisko dated December 3, 2008	Form 10-K 3/19/09	10.12
10.11.2*	Compensation Agreement by and between Safeguard Scientifics, Inc. and Brian J. Sisko dated December 14, 2009	Form 10-K 3/16/10	10.11.2

10.12.1	Amended and Restated Loan and Security Agreement dated as of May 27, 2009, by and among Silicon Valley Bank, Safeguard Scientifics, Inc., Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 8-K 5/28/09	10.1

89

Table of Contents

Exhibit Number	Description	Incorporated Filing Reference Form Type & Filing Date	Original Exhibit Number
10.12.2	Joinder and First Loan Modification Agreement dated as of December 31, 2010, by and among Silicon Valley Bank, Safeguard Scientifics, Inc., Safeguard Delaware, Inc., Safeguard Scientifics (Delaware), Inc. and Safeguard Delaware II, Inc.	Form 8-K 1/4/11	10.1
10.12.3	Second Loan Modification Agreement dated as of April 29, 2011, by and among Silicon Valley Bank, Safeguard Scientifics, Inc., Safeguard Delaware, Inc., Safeguard Scientifics (Delaware), Inc. and Safeguard Delaware II, Inc.	Form 8-K 7/28/11	10.1
10.13	Purchase and Sale Agreement dated as of December 9, 2005 by and among HarbourVest VII Venture Ltd., Dover Street VI L.P. and several subsidiaries and affiliated limited partnerships of Safeguard Scientifics, Inc.	Form 10-K 3/13/06	10.36
10.14	Consent Agreement, dated as of May 17, 2011, by and among Shire Pharmaceuticals, Inc. and certain stockholders of Advanced BioHealing, Inc.	Form 8-K 5/18/11	10.1
14.1	Code of Business Conduct and Ethics		
21.1	List of Subsidiaries		
23.1	Consent of Independent Registered Public Accounting Firm KPMG LLP		
23.2	Consent of Independent Registered Public Accounting Firm Deloitte & Touche LLP		
31.1	Certification of Peter J. Boni pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934		
31.2	Certification of Stephen T. Zarrilli pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934		
32.1	Certification of Peter J. Boni pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.		
32.2	Certification of Stephen T. Zarrilli pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.		
99.1	Consolidated Financial Statements of Clarient, Inc.		
101	The following materials from Safeguard Scientifics, Inc. Annual Report on Form 10-K for the year ended December 31, 2011, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets -December 31, 2011 and 2010; (ii) Consolidated Statements of Operations - Years ended December 31, 2011, 2010 and 2009; (iii) Consolidated Statements of Comprehensive Income (Loss) - Years ended December 31, 2011, 2010 and 2009 (iv) Consolidated Statements of Changes in Equity - Years ended December 31, 2011, 2010 and 2009 (v) Condensed Statements of Cash Flows - Years ended December 31, 2011, 2010 and 2009; and (vi) Notes to Consolidated Financial Statements, tagged as blocks of text**.		

Filed herewith

* These exhibits relate to management contracts or compensatory plans, contracts or arrangements in which directors and/or executive officers of the Registrant may participate.

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1943, as amended, and otherwise are not subject to liability under those sections.

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.

By: PETER J. BONI
PETER J. BONI
President and Chief Executive Officer

Dated: March 02, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
PETER J. BONI Peter J. Boni	President and Chief Executive Officer and Director (Principal Executive Officer)	March 02, 2012
STEPHEN T. ZARRILLI Stephen T. Zarrilli	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 02, 2012
JULIE A. DOBSON Julie A. Dobson	Director	March 02, 2012
ANDREW E. LIETZ Andrew E. Lietz	Chairman of the Board of Directors	March 02, 2012
GEORGE MACKENZIE George MacKenzie	Director	March 02, 2012
GEORGE D. MCCLELLAND George D. McClelland	Director	March 02, 2012
JACK L. MESSMAN Jack L. Messman	Director	March 02, 2012
JOHN J. ROBERTS John J. Roberts	Director	March 02, 2012
ROBERT J. ROSENTHAL Robert J. Rosenthal	Director	March 02, 2012