

# SAFEGUARD SCIENTIFICS INC

## FORM 10-K (Annual Report)

Filed 03/27/07 for the Period Ending 12/31/06

Address	435 DEVON PARK DR BLDG 800 WAYNE, PA 19087
Telephone	6102930600
CIK	0000086115
Symbol	SFE
SIC Code	6799 - Investors, Not Elsewhere Classified
Industry	Misc. Financial Services
Sector	Financial
Fiscal Year	12/31

# SAFEGUARD SCIENTIFICS INC

## FORM 10-K (Annual Report)

Filed 3/27/2007 For Period Ending 12/31/2006

Address	435 DEVON PARK DR BLDG 800 WAYNE, Pennsylvania 19087
Telephone	610-293-0600
CIK	0000086115
Industry	Computer Peripherals
Sector	Technology
Fiscal Year	12/31

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**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**Form 10-K**

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

For the Fiscal Year Ended December 31, 2006

Commission File Number 1-5620

**Safeguard Scientifics, Inc.**

*(Exact name of Registrant as specified in its charter)*

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

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

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

**19087**  
*(Zip Code)*

**(610) 293-0600**  
*(Registrant's telephone number, including area code)*

**Securities registered pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of each exchange on which registered
Common Stock (\$.10 par value)	New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes  No

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

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Yes  No

As of June 30, 2006, the aggregate market value of the Registrant's common stock held by non-affiliates of the registrant was \$257,629,375

based on the closing sale price as reported on the New York Stock Exchange.

The number of shares outstanding of the Registrant's Common Stock, as of March 22, 2007 was 120,771,313.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive proxy statement (the "Definitive Proxy Statement") to be filed with the Securities and Exchange Commission for the Company's 2007 Annual Meeting of Shareholders are incorporated by reference into Part III of this report.

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**SAFEGUARD SCIENTIFICS, INC.**  
**FORM 10-K**  
**DECEMBER 31, 2006**

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	Amended and Restated Loan Agreement for \$15 million by and among Comerica Bank, Alliance Consulting Group Associates, Inc. and Alliance Holdings, Inc.	
	Amended and Restated Loan Agreement for \$5 million by and among Comerica Bank, Alliance Consulting Group Associates, Inc. and Alliance Holdings, Inc.	
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	Certification of Peter J. Boni pursuant to 18 U.S.C. Section 1350	
	Certification of Stephen T. Zarrilli pursuant to 18 U.S.C. Section 1350	



## PART I

### 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,” “seeks,” “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, 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.

### Item 1. Business

#### Business Overview

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

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

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

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

In 2006, our management team set forth five strategic objectives:

- Reposition Safeguard from an operating company to a holding company;
- Time the acquisition and disposition of partner companies to achieve maximum risk-adjusted value;
- Ignite our deal machinery process, from sourcing partner company candidates through completing transactions;
- Augment our organization, both internally and externally, so that we can achieve our goals; and
- Execute these objectives boldly, with focused effort.

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As a result of achieving our goals in 2006, our management team has shifted focus to four strategic objectives for 2007:

- Deploy capital in companies within our strategic focus;
- Build value in our partner companies with strong management teams using organic and acquisitive growth to position our partner companies for liquidity at premium valuations;
- Realize the value of select partner companies through selective, well-timed exits to maximize risk-adjusted value; and
- Provide the tools needed for investors to fully recognize the shareholder value that has been created by our efforts.

To meet these strategic objectives during 2007, Safeguard will focus on:

- finding opportunities to deploy our capital in additional partner company holdings;
- helping to achieve additional market penetration, revenue growth, cash flow improvement and growth in the long-term value of our current partner companies:

Acsis, Inc.

NuPathe, Inc.

Advantaged Healthcare Solutions, Inc.

Pacific Title & Art Studio, Inc.

Alliance Consulting Group Associates, Inc.

Portico Systems, Inc.

Clariant, Inc.

PROMODEL Corporation

Laureate Pharma, Inc.

Rubicor Medical, Inc.

Neuronyx, Inc.

Ventaira Pharmaceuticals, Inc.

NexTone Communications, Inc.

- realizing value in our partner companies if and when we believe doing so will maximize value for our shareholders.

We incorporated in the Commonwealth of Pennsylvania in 1953. Our corporate headquarters is located at 435 Devon Park Drive, Building 800, Wayne, Pennsylvania 19087.

### Significant 2006 Highlights

We are proud of our key accomplishments in 2006:

#### *Realizing Value :*

- We sold our interest in Mantas, Inc. to i-flex solutions, ltd., an affiliate of Oracle Corporation, for \$112.8 million, for which we recognized a pre-tax gain of approximately \$83.9 million. The sale price reflected a 3.9x premium over our carrying value of Mantas, and represented a significant premium over recent valuations of firms in Mantas' line of business based upon multiples of revenue and earnings.
- We provided strategic and operational guidance and resources to Alliance Consulting Group Associates, Inc. in the sale of its southwestern U.S. operations for \$4.5 million to Logicalis, Inc. Alliance Consulting booked a gain of \$1.6 million from this sale.
- We sold our interest in Traffic.com, Inc. for \$3.2 million, recognizing a gain of \$0.4 million, and in Garage.com, Inc. for \$1.2 million, all of which was recognized as a gain.

#### *Deploying Capital :*

- We acquired 12% of Authentium, Inc. for \$5.5 million, enabling this leading provider of security software to internet service providers to expand its growth strategies.

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- We provided \$6.0 million of equity capital to Acsis, Inc. to fund its growth strategies and expand its business increasing our ownership to 96%.
- We provided Clariant, Inc. \$3 million of equity capital to support its purchase of the assets of Trestle Holdings, Inc.
- We provided strategic guidance and operational support for Alliance Consulting's acquisition of the assets of Fusion Technologies, Inc. for \$5.6 million, enabling Alliance Consulting to leverage its Indian technology center resources for clients throughout the world.
- We purchased 36% of Rubicor Medical, Inc. for \$20 million, allowing this medical device company to work toward the launch of its innovative products for breast cancer biopsy and removal.
- We purchased 47% of Portico Systems, Inc. for \$6.0 million, allowing Portico to pursue product and service development for its health plan business process software platform.
- We acquired 21% of NuPathe, Inc. for \$3.0 million as part of a \$15.0 million financing that positions NuPathe to advance clinical development of novel transdermal delivery technology for treatment of migraines and central nervous system disorders.
- We acquired 32% of Advantedge Healthcare Solutions, Inc. for \$5.8 million as part of an up to \$20.0 million financing to accelerate its organic growth and make future acquisitions.
- Over the course of 2006, we purchased \$21.0 million in face value of our 2.625% Convertible Senior Debentures due 2024 for an aggregate of \$16.4 million, including accrued interest, resulting in a net gain of \$4.3 million.

### *Augmenting and Building Value :*

- We added George D. McClelland and Michael J. Cody to our Board of Directors. Mr. McClelland has served in executive management capacities in information technology, life sciences and private equity businesses. Mr. Cody brings to the Board extensive experience in strategic acquisitions and investments, and currently serves as vice president of corporate development for EMC Corp.
- We made key hires and promotions in our Life Sciences and Technology Groups, as well as for our investor relations, marketing and support functions.
- We formed Technology and Life Sciences Advisory Boards, comprised of prominent industry leaders with specialized knowledge and expertise in their respective sectors. The Advisory Boards augment our internal resources and provide expert guidance and strategic direction to Safeguard and its partner companies, as well as identifying and evaluating deal opportunities.
- In July, our common stock was added to the Russell 2000<sup>®</sup> Index, a leading benchmark of small-cap stocks compiled by the Russell Investment Group.

## **Our Strategy**

We focus on companies that address the strategic challenges facing businesses today, and the opportunities they present. We believe these challenges have five general themes:

- **Maturity**—existing technologies, solutions and therapies are reaching the end of their designed life or patent protection; the population of the U.S. is aging; businesses based on once-novel technologies are now facing consolidation and other competitive pressures.
- **Migration**—technology platforms are migrating to newer technologies and facing changing cost structures; medical treatments are moving toward earlier stage intervention; and business models are migrating toward different revenue-generation models integrating technologies and services.
- **Convergence**—technology and life sciences are intersecting, in fields like medical devices and targeted diagnostics for targeted therapies.
- **Compliance**—business spending is being driven by new or increased regulation in both technology and life sciences.

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- Cost containment—both technology and life sciences are facing increasing pressure for cheaper, yet better solutions.

These themes tend to attract entrepreneurs who need capital support and strategic guidance. Safeguard deploys growth capital along with management expertise, process excellence and marketplace insight designed to provide tangible benefits to growth companies.

Our corporate staff (31 employees at December 31, 2006) is dedicated to creating long-term value for our shareholders by helping our partner companies build value and by finding additional acquisition opportunities.

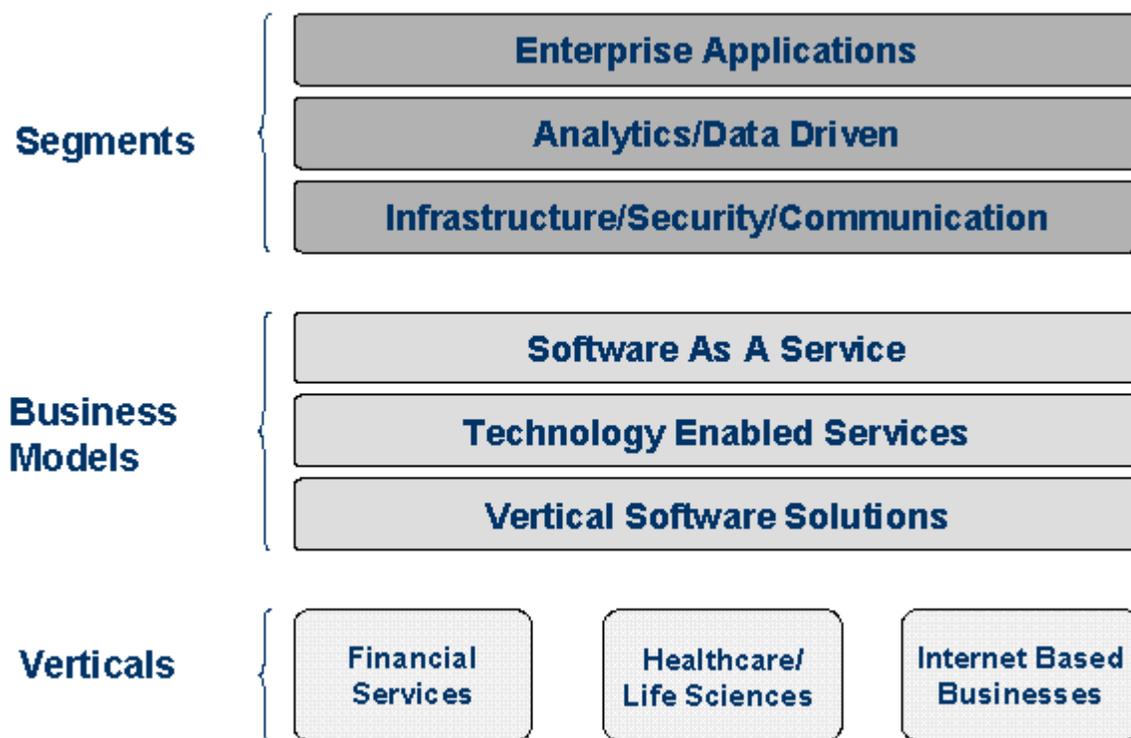
### *Identifying Opportunities*

Safeguard's marketing and sourcing activities are designed to generate a large volume of high-quality opportunities. Our primary focus is on acquiring majority or minority stakes in growth-stage companies within the technology and life sciences industries with attractive growth prospects. Generally, we prefer candidates:

- operating in large or growing markets;
- with barriers to entry by competitors, such as proprietary technology and intellectual property, or other competitive advantages;
- with capital requirements between \$5 million and \$50 million; and
- with a compelling strategy for achieving growth.

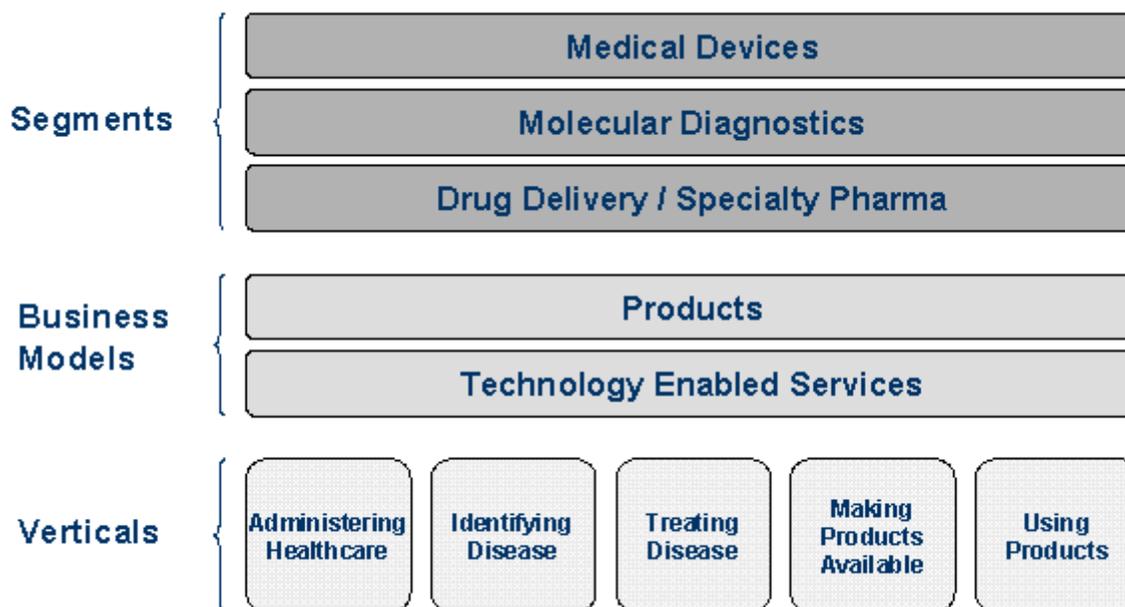
We target our sourcing efforts on the Northeast/Mid-Atlantic region of the U.S. — although we evaluate candidate companies opportunistically throughout the U.S. and southern Canada.

Our Technology Group currently targets companies with the following business models in these technology segments and vertical markets:



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Our Life Sciences Group currently targets companies with the following business models in these segments and vertical markets:



We believe there are many opportunities within these segments and vertical markets, and our sourcing activities are focused on finding candidate companies and evaluating how well they align with our criteria. However, we recognize we may have difficulty identifying candidate companies and completing transactions on terms we believe appropriate. As a result, we cannot be certain how frequently we will complete acquisitions.

*Competition.* We face intense competition from other companies that acquire, or provide capital to, technology and life sciences businesses. Competitors include venture capital and private equity investors, as well as companies seeking to make strategic acquisitions. Many providers of growth capital also offer strategic guidance, networking access for recruiting and general advice. Nonetheless, we believe we are a preferable capital provider to growth-stage companies because our strategy and capabilities offer:

- responsive operational assistance, including strategy design and execution, business development, corporate development, sales, marketing, finance, facilities, human resources and legal support;
- the flexibility to structure minority or majority transactions with equity and debt;
- liquidity opportunities for founders and investors;
- a focus on maximizing *risk-adjusted* value growth, rather than *absolute* value growth within a narrow or predetermined time frame;
- interim c-level management support, as needed;
- opportunities to leverage Safeguard's balance sheet for borrowing and stability; and
- a record of building revenue growth in our partner companies.

### *Helping Our Partner Companies Build Value*

We offer operational and management support to each of our partner companies through experienced professionals. Our employees have expertise in the areas of business and technology strategy, sales and marketing, operations, finance, legal and transactional support. We provide hands-on assistance to the management of our partner companies to support their growth. We believe our strengths include:

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- applying our expertise to support the company's introduction of new products and services;
- leveraging our market knowledge to generate additional growth opportunities;
- leveraging our business contacts and relationships; and
- identifying and evaluating potential acquisitions and providing capital to pursue potential acquisitions to accelerate growth.

*Strategic Support.* By helping our partner companies' management teams remain focused on critical objectives through provision of human, financial and strategic resources, we believe we are able to accelerate their development and success. We play an active role in determining the strategic direction of our partner companies, including:

- defining short- and long-term strategic goals;
- identifying and planning for the critical success factors to reach these goals;
- identifying and addressing the challenges and operational improvements required to achieve the critical success factors and, ultimately, the strategic goals;
- identifying and implementing the business measurements that we and others will apply to measure the company's success; and
- providing capital to drive growth.

*Management and Operational Support.* We provide management and operational support to our partner companies in order to accelerate their growth. We engage in ongoing planning and assessment of the development of our partner companies and their management teams. Our executives and our Advisory Boards provide mentoring, advice and guidance to develop the management of our partner companies. Our executives generally serve as directors of our partner companies and work with them to develop and implement strategic and operating plans. We measure and monitor achievement of these plans through regular operational and financial performance measurements. We believe these services provide our partner companies with significant competitive advantages within their respective markets.

### ***Realizing Value***

In general, we will hold our stake in a partner company as long as we believe the risk-adjusted value of that stake is maximized by our continued ownership and effort. From time to time, we engage in discussions with other companies interested in our partner companies, either in response to inquiries or as part of a process we initiate. To the extent we believe that a partner company's further growth and development can best be supported by a different ownership structure or if we otherwise believe it is in our shareholders' best interests, we may sell some or all of our stake in the partner company. These sales may take the form of privately negotiated sales of securities or assets, public offerings of the partner company's securities and, in the case of our publicly traded partner companies, sales of their securities in the open market. We have in the past taken partner companies public through rights offerings and direct share subscription programs, and we will continue to consider these (or similar) programs to maximize shareholder value. We expect to use the proceeds from these sales (and sales of other assets) primarily to pursue other candidate company opportunities or for other working capital purposes.

### Our Partner Companies

An understanding of our partner companies is important to understanding Safeguard and its value-building strategy. Following are more detailed descriptions of our majority-owned partner companies. The ownership percentage is presented as of December 31, 2006 and reflects the percentage of the vote we are entitled to cast based on issued and outstanding voting securities, excluding the effect of options, warrants and convertible debt. From time to time we may seek to opportunistically increase our position or sell some or all of our interests in these companies.

#### *Acsis, Inc.*

**(Safeguard Ownership: 96%)**

*Safeguard Opportunity.* We acquired Acsis in December 2005 because we believe Acsis is and will be integral to the migration of mature supply-chain management systems to include newer technologies, such as radio-frequency identification (RFID) in a heterogeneous environment that will integrate the manufacture and distribution floors into Enterprise Resource Planning (ERP) systems. Many Fortune 1000 clients already leverage Acsis' solutions to obtain labor efficiencies and supply chain visibility. We believe that powerful industry trends—business process automation, RFID compliance mandates, and compliance with regulations mandating tracking of food and drug products—provide a large market and growth opportunity for Acsis. Spending on enterprise data collection software and services has been growing significantly, and Acsis believes it currently exceeds \$1 billion annually. Recent mandates from major national retailers as well as government agencies have prompted manufacturers to upgrade their existing data collection infrastructure with RFID technology.

*General.* Acsis ([www.acsisinc.com](http://www.acsisinc.com)) is a leading provider of software and service solutions that assist manufacturing companies in improving efficiencies throughout the entire supply-chain. Its solutions enable manufacturers to automate plant floor/warehouse operations and take advantage of emerging automated-ID technologies, including RFID and barcode. Acsis' solutions provide the critical data links between activities or material movements that take place on the shop floor and ERP systems. They improve visibility of goods throughout supply-chains, ultimately resulting in increased revenues, improved customer service and reduced costs. Founded in 1996, Acsis offered one of the first solutions to facilitate the control and integration of plant floor and warehouse devices with SAP's ERP software.

*Strategy.* Acsis' strategy is to leverage its wide and deep experience in a variety of vertical industries, such as chemical, pharmaceutical and consumer packaged goods, to craft real-time supply-chain solutions for SAP™ R/3® as well as other enterprise systems. Acsis' knowledge of the business processes and typical transactions in these industries allows it to deliver tailored solutions. Acsis couples this with broad expertise in SAP R/3 implementations, automated data-collection and integration solutions, and a proven track record. Acsis also has strategic partnerships with leading technology providers and consultants. As an example, Acsis was the first to successfully complete the integration testing between its xDDi software and SAP's Auto-ID Infrastructure component of the SAP NetWeaver™ open integration and application platform.

Manufacturers are upgrading and enhancing their existing infrastructure to improve efficiencies and integrate new technologies like RFID. Manufacturers are making these investments not only in response to governmental and retailer mandates, but also to maximize the benefits of just-in-time inventory practices. Acsis believes its solutions provide them with better ways to:

- constantly view and manage every link in their supply-chain in real time;
- communicate and control changes in their supply-chain;
- automate the collection and integration of critical data from any source; and
- protect their processes from interruption.

*Solutions.* Acsis draws from a variety of technologies and service offerings to create a solution that matches the client's business, budget and IT environment. Solutions range from value-added services for implementing SAPConsole to the advanced shop floor process automation and data collection using the xDDi as a shop floor platform. If requested, Acsis will also procure all necessary hardware and software to deliver a turnkey data-collection system.

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Acsis' key internally-developed software solution components featured in the Acsis Lean Enterprise Suite ("ALES")—a bundled set of applications that connects people, devices and supply chain events with client ERP systems. ALES is comprised of the following components:

- **xDDi (xApp for Device and Data Integration) Software**
  - enterprise software solution enabling data collection from any device in the supply-chain (such as scales, optical eyes printers bar code scanners and RFID tags) and aggregate filter and translate it for integration with ERP systems
  - converts SAP process and workflows into manageable shop floor events, directs employee task lists (via handheld devices or vehicle mounted units) and integrates the resulting data back to SAP
- **Enterprise Label Management Software**
  - enterprise software solution enabling users to design and generate customer-specific label formats directly from SAP ERP data and manage them from a central location
  - enables users to manage label formats across your enterprise to reduce time and costs, and insures compliance to reduce shipment rejections, incorrect shipments and mislabeling
- **Line Manager Appliances**
  - intelligent appliances to support RFID- and barcode-based product tracking for warehouse, manufacturing, packing and shipping operations
  - automates manufacturing, packing, labeling and shipping operations, and manages events and alerts to proactively notify users of significant process events in order to improve quality and prevent production delays
- **Plant Manager Software**
  - enterprise software solution helping users efficiently execute manufacturing and warehouse operations
  - allows operations to be monitored from receiving to manufacturing and through distribution, and management of key performance indicators for real-time visibility of work orders throughout all manufacturing and warehouse facilities
- **RFID Analytics**
  - helps users gain product visibility and intelligence throughout your supply chain by analyzing key metrics

Acsis works with its clients to develop manufacturing, warehousing, RFID and mobile solutions tailored to the client's needs and budget. Acsis also maintains a highly-experienced and trained professional services group to provide consulting and technical services. Typical professional service engagements include:

- problem analysis and business case development;
- enterprise systems design;
- data modeling;
- process evaluations and recommendations;
- hardware and software evaluation;
- help desk;
- application maintenance and enhancements; and
- communications and connectivity.

*Offices and Employees.* Acsis employs approximately 109 people at its headquarters in Marlton, New Jersey, and in Munich, Germany.

*Sales and Marketing; Customers.* Acsis has a track record including more than 650 implementations in 28 countries. Acsis' typical customers are large manufacturing, pharmaceutical or consumer packaged goods businesses with more than \$1 billion in revenue and substantial international operations. In 2006, two customers each represented more than 10% of Acsis's revenue.

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Sales are typically made in warehouse, logistics, fulfillment or other operations units of its clients with a customary sales cycle of three to six months. At the end of a sales cycle, Acsis provides consulting, blueprinting and implementation services, go-live support and ongoing help desk support. Acsis then works with customers on a regular and ongoing basis to support their operations and provide further benefits with additional solutions or by implementing solutions at additional sites. Approximately half of Acsis' customer base utilizes multiple solutions provided by Acsis, and many customers are using Acsis' solutions in multiple sites across the world.

*Competition.* Acsis' competition generally comes from large, diversified consulting businesses or niche providers with a variety of individual solutions for barcode, RFID or other data collection systems. Acsis seeks to differentiate itself by proving a single, integrated platform which can be used across the enterprise to increase efficiencies and reduce operational costs.

### *Alliance Consulting Group Associates, Inc.*

**(Safeguard Ownership: 99%)**

*Safeguard Opportunity.* We acquired Alliance Consulting in December 2002 because we saw a growing and highly fragmented market in which we believed Alliance Consulting could achieve profitable growth. Capitalizing on its deep domain expertise in the pharmaceutical, healthcare, financial services, manufacturing and high tech distribution industries, its extensive staff resources and strong customer relationships, we believe that Alliance Consulting can continue to grow its profitability.

*General.* Alliance Consulting ([www.alliance-consulting.com](http://www.alliance-consulting.com)) is a leading national business intelligence solutions consultancy providing services to primarily Fortune 2000 clients in the pharmaceutical, financial services, manufacturing and high tech industries. Alliance Consulting specializes in two practice areas:

- Information Management, which is comprised of a full range of business intelligence solutions from data acquisition and warehousing to master data management, analytics and reporting; and
- Application Services, which includes software development, integration, testing and application support, delivered through a high quality and cost effective hybrid global delivery model.

*Strategy.* Alliance Consulting has developed a strategy focused on enabling business intelligence through the application of domain experience and custom-tailored project teams to deliver software solutions and consulting services. Alliance Consulting believes that its growth opportunities benefit from the following industry trends:

- The volume of data being processed by businesses is increasing at an exponential rate, making businesses dependent upon the effective and efficient processing of this data and requiring significant and ongoing investment in technology infrastructure and resources, but with continuing decreases in the cost of computing power, storage and communication systems.
- The complexity of this data is increasing, with multiple and diverse inflow sources containing a wide variety of structured and unstructured information.
- The value to the business of this data is increasing, driven in part by regulatory and compliance requirements and strategic and competitive pressures, yet businesses are facing continuing budget constraints, prompting the need to maximize cost-effective solutions.

*Services.* Through an integrated network of local branch offices in North America, and its offshore development centers located in Hyderabad and Bangalore, India, Alliance Consulting provides a flexible engagement approach to its clients, using fixed bid or time and materials pricing models; teams or individual consultants; on-site, off-site or offshore delivery; and short- or long-term support.

Alliance Consulting's services are targeted to:

- **Business intelligence and data management** — using data warehousing technologies to develop complete business intelligence infrastructures, applications and processes to enhance the competitiveness of clients.

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- **Corporate performance management** — using enterprise-wide reporting and analysis, forecasting and budgeting and other tools to provide real-time information, enabling corporate managers to better monitor critical operating performance metrics and implement rapid, targeted adjustments to increase effectiveness, efficiency and profitability.
- **Application development** — using assessment tools, architecture design and implementation of advanced, scalable and flexible, customized software solutions to leverage existing software assets through the integration of state-of-the-art web-based technologies.
- **Outsourcing** — working with clients to understand the IT support needs of the business, costs and internal/external service capabilities and then implementing outsourcing solutions for data center operations, applications development and maintenance, distributed and desktop processing, voice and data networks, Internet and web hosting and help/service desk functions.

Alliance Consulting maintains a full-time core staff complemented by a flexible combination of hourly employees and independent contractors, providing clients with specialized engagement teams tailored to their specific business requirements. This approach enables Alliance Consulting to offer a precise combination of technical, industry, and process knowledge to support each engagement while maximizing utilization of its staff and contracting consultants. Alliance Consulting's employee and independent contractor resources are supported on an ongoing basis through internal and external recruiting targeted at high-quality, experienced professionals with significant product and industry expertise.

*Offices and Employees.* Alliance Consulting is headquartered in Conshohocken, Pennsylvania, and it operates five other regional offices and three satellite locations throughout the United States and two primary locations in India. Alliance Consulting supplements its full-time employees by utilizing subcontractors. At December 31, 2006, Alliance Consulting had 697 full-time employees and approximately 205 subcontractors. Alliance Consulting believes its relationship with its employees and subcontractors is good. Alliance Consulting believes its growth and success are dependent on the caliber of its people and will continue to dedicate significant resources to hiring, training and development, and career advancement programs.

During 2006, Alliance Consulting sold its non-core southwest regional operation with offices in Phoenix, Los Angeles and Dallas, along with associated client activity and consultants, to Logicalis, Inc. The Company used the proceeds of the sale to acquire Fusion Technologies, an application outsourcing provider with significant operations in Hyderabad and Bangalore, India. This acquisition more than doubled Alliance Consulting's capacity for application outsourcing work in India, and added several strong reference clients in financial services and high tech in the United States.

*Sales and Marketing; Customers.* Alliance Consulting uses a customer relationship-based approach to generating new clients and new engagements with existing clients. Some of Alliance Consulting's clients include JP Morgan Chase, Wyeth Pharmaceuticals, Pfizer Pharmaceuticals, Johnson & Johnson and EMC. Alliance Consulting markets its services through a direct sales force, which is based in regional and satellite offices. Account executives are assigned to a limited number of accounts so they can develop an in-depth understanding of each client's individual needs and form strong client relationships. In 2006, two customers each represented more than 10% of Alliance Consulting's revenue. In 2005, the same two customers each represented more than 10% of Alliance Consulting's revenue.

Following common industry practice, many of Alliance Consulting's orders are terminable by either the client or Alliance Consulting on short notice. Because many clients can cancel or reduce the scope of their engagements on short notice, Alliance Consulting does not believe that backlog is a reliable indication of future business.

*Competition.* Alliance Consulting's revenue potential is largely dependent upon target customers' spending for IT services and its ability to compete with local, national and offshore providers of consulting services. Many of these competitors (such as major IT consulting firms) have greater financial and human resources than Alliance Consulting. Alliance Consulting believes that the basis for competition in its industry includes the ability to create an integrated solution that best meets the needs of an individual customer, provide competitive cost pricing models,

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develop strong client relationships, provide high-quality consultants with industry and process specific technical expertise, and offer flexible client-service delivery options.

### *Clariant, Inc.*

**(Safeguard Ownership: 60%)**

*Safeguard Opportunity.* Safeguard first took an ownership interest in Clariant in 1996, and we have increased our ownership position over time. Shares of Clariant's common stock trade on the Nasdaq Capital Market under the symbol "CLRT."

We believe that increasingly specific targeted cancer therapies will need more specialized and complex diagnostic tests in order to improve cancer therapy outcomes. The continued aging of the U.S. and European populations, coupled with the higher incidence of cancer among seniors, support an expanding market for Clariant's services. Clariant is now leveraging its technical expertise, access to proprietary technology and capital investment to provide its diagnostic services to a larger customer base.

*General .* Clariant ([www.clariantinc.com](http://www.clariantinc.com)) is a comprehensive cancer diagnostics company providing cellular assessment and cancer characterization to community pathologists.

Clariant's goal is to be positioned to capture a substantially greater portion of the cancer diagnostics market by serving the needs of the market from drug discovery through clinical practice through a technology-empowered laboratory, deploying the best available testing platforms and leveraging the Internet to deliver this information to the community pathologist.

*Strategy.* Clariant's mission is to be the leader in cancer diagnostics by building collaborative relationships with the health care community in order to translate cancer discovery and information into better patient care. To accomplish this, Clariant focuses on identifying high-quality opportunities to increase profitability and differentiate its service offerings in its highly-competitive market. An important aspect of Clariant's strategy is to combine its medical expertise with proprietary technologies to develop novel diagnostic tests and analytical capabilities. In particular, Clariant is seeking to deploy novel markers, or biomarkers, which are characteristics of an individual's tumor or disease that, once identified and qualified, allow for more accurate prognosis, diagnosis and treatment. Broader discovery and use of novel markers is hoped to clarify and simplify decisions for healthcare providers and the biopharmaceutical industry. The growing demand for personalized medicine has generated a need for these novel diagnostics.

*Services.* Clariant provides a wide variety of cancer diagnostics and consultative services, ranging from technical laboratory services to professional interpretation. By combining core competencies in image analysis and data quantification with its knowledge of virtual environments, Clariant has created valuable service offerings for pathologists in practice and research. Clariant believes that the growing need for precise diagnosis combined with the ability to put comprehensive information into a single, coherent computer-accessible platform for clinicians presents development opportunities for new directed diagnostic services using the image analysis platform. Clariant offers a broad menu of specialized technologies such as image analysis, fluorescent in situ hybridization (FISH), flow cytometry, cytogenetics and molecular diagnostics. Within anatomic pathology, Clariant focuses on the top four solid tumors (breast, prostate, lung and colon), which represent 61% of all new cases.

Clariant also provides hematopathology testing for leukemia and lymphoma, and expects to expand service offerings as new assays emerge. For biopharmaceutical companies and other research organizations, Clariant offers a complete compliment of commercial services to assist their efforts, ranging from drug discovery to the development of directed diagnostics through clinical trials.

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*Sale of Technology Group.* On March 8, 2007, Clariant sold its technology group business (which developed, manufactured and marketed the ACIS<sup>®</sup> Automated Image Analysis System) and related intellectual property to Zeiss MicroImaging, Inc. (the “ACIS Sale”) for an aggregate purchase price of \$12.5 million (including \$1.5 million in contingent purchase price). As part of the ACIS Sale, Clariant entered into a license agreement with Zeiss pursuant to which Zeiss granted the Company a non-exclusive, perpetual and royalty-free license to certain of the transferred intellectual property for use in connection with imaging applications and the Company’s laboratory services business. Clariant and Zeiss also committed to pursue a strategic joint development arrangement to develop novel markers and new menu applications for the ACIS product line.

*Sales and Marketing.* Most of Clariant’s sales resources are dedicated to the growing diagnostic services business. Targeting community pathology practices and hospitals, the sales process is designed to understand the customer’s needs and develop appropriate solutions from its range of laboratory service options. Clariant’s sales approach focuses on expanding organic sales within its current customer base as well as potential customers. Marketing efforts focus on establishing a strong and distinctive brand identity for Clariant’s diagnostic services within the targeted segment of community pathologists. Clariant uses its CONTINUUM<sup>™</sup> national and regional seminar and webinar programs designed to provide a one-on-one collaborative environment for its advisory board and medical staff to interact directly with potential customers.

*Patents and Proprietary Technology.* Clariant seeks to broaden the scope of its intellectual property portfolio for laboratory services methodologies, using automated cellular instrumentation, rare event identification, and proteomic mathematic capabilities. As part of the ACIS Sale, Clariant transferred its patent portfolio and related intellectual property to Zeiss. However, Clariant retained a license to use certain of that intellectual property, which Clariant plans to use in the development of new tests, applications, unique analytical capabilities and other service offerings, including novel markers. Clariant also relies on trade secrets and proprietary know-how that it seeks to protect, in part, through confidentiality agreements with employees and consultants. If Clariant is unable to protect its patents and proprietary rights, its reputation and competitiveness in the marketplace could be materially damaged.

*Competition.* The clinical laboratory business is highly competitive and dominated by several national laboratories, as well as many smaller niche and regional organizations. Clariant’s primary competitors include large independent laboratories that offer a wide test and product menu on a national scale. These large national independent laboratories have significantly greater financial, sales and logistical resources than Clariant and may be able to achieve greater economies of scale, or establish contracts with payor groups on more favorable terms. Clariant also competes with smaller niche laboratories that address a narrow segment of the esoteric market by offering very specific assay menus. Finally, institutions that are affiliated with large medical centers or universities compete with Clariant on the limited basis of perceived quality of service.

Companies within the diagnostic testing industry are also responding to new technologies, products and services. We believe some of Clariant’s current competitors — as well as other currently non-competitive companies — are actively conducting research in areas where Clariant is also conducting development activities. The products and services these companies develop may directly compete with Clariant’s current or potential services, or may address other areas of diagnostic evaluation, making those companies compete more effectively against Clariant. Furthermore, because the diagnostic testing market is sensitive to the timing of product and service availability, quickly developing and achieving clinical study and regulatory success may provide an advantage.

*Research & Development.* With the ACIS Sale complete, Clariant’s research and development efforts are now primarily focused on developing new assays and novel cancer markers to commercialize for its laboratory services business. Quality and regulatory staff assure that every developed test and application meets stringent regulatory guidelines. Research and development spending by Clariant (which had been primarily focused on improving the ACIS technology) was approximately \$4.5 million, \$3.7 million and \$4.1 million in 2006, 2005, and 2004, respectively. As a result of the ACIS Sale, we expect Clariant’s research and development expenses to decline substantially in 2007.

*Governmental Regulation.* Because Clariant operates a clinical laboratory, many aspects of its business are subject to the complex federal, state and local regulations applicable to laboratory operations. In particular, the federal Clinical Laboratory Improvement Amendments (CLIA) specify the quality standards for proficiency testing, patient test management, quality control, personnel qualifications and quality assurance for Clariant’s laboratory. Clariant received its CLIA certification in late 2004. In addition, Clariant’s facilities have been issued licenses to provide laboratory diagnostic services in California. The State of California could prohibit provision of laboratory services if Clariant

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fails to maintain or renew these licenses. Additionally, requirements of states where laboratory services may be provided have various application and provisional requirements that must be satisfied. Laws and regulations pertaining to the services provided by Clariant are subject to change and depend heavily on administrative interpretations by federal and state agencies.

*Facilities.* In 2006, Clariant moved all of its operations into a new 78,000 square foot facility in Aliso Viejo, California to expand its capacity and allow for the ongoing growth. Clariant currently occupies approximately 43,000 square feet of that facility, and has subleased an additional 34,000 square feet.

*Employees.* As of December 31, 2006, Clariant had 204 employees. As a result of the ACIS Sale, at March 9, 2007, Clariant had 171 employees: 119 in laboratory diagnostics positions (including product development); 23 in finance, executive and administrative positions; and 29 in sales and marketing positions. Clariant believes that its relationship with its employees is good.

### *Laureate Pharma, Inc.*

**(Safeguard Ownership: 100%)**

*Safeguard Opportunity.* We acquired the business and assets operated by Laureate Pharma in December 2004. We made this acquisition because we recognized that the substantial growth in sales of biotechnology products has spurred a significant investment by large pharmaceutical companies and smaller biotechnology companies in the development of new biotechnology products for human therapeutics. Few of these companies, particularly biotechnology companies have the resources or expertise to manufacture the quantities of drug product needed to conduct clinical trials and commercialize approved products. Laureate Pharma provides its customers with a cost-effective, lower-risk alternative, which also improves the quality of their products and processes and reduces time-to-market.

*General.* Laureate Pharma ([www.laureatepharma.com](http://www.laureatepharma.com)) is a full-service contract manufacturing organization (CMO) providing critical development and current Good Manufacturing Practices (cGMP) manufacturing services. Laureate Pharma manufactures small- and medium-scale quantities of biopharmaceutical products in its FDA-registered facility. Laureate Pharma's clients use these supplies (depending on their regulatory status) for preclinical studies, clinical trials or commercial sales. Laureate Pharma seeks to become a leader in this segment of the biopharmaceutical industry by delivering superior development and manufacturing services to its customers. Laureate Pharma's headquarters and manufacturing facility is located in Princeton, New Jersey.

*Strategy.* Laureate Pharma's strategy is to build on its strong customer relationships and generate new customers, to increase its new services and products, and to maintain its reputation for high quality in the use of state-of-the-art technology to deliver products and services that meet applicable regulatory, environmental and safety requirements, including cGMPs.

Laureate Pharma believes its growth opportunities are driven by the following industry trends:

- Substantial growth in the development of biotechnology products for human therapeutics, representing an increasing percentage of the total pharma pipeline.
- Demand for manufacturing capacity, along with the significant capital required to build capacity, creating increased opportunities for outsourced services.
- Need for product development support, equipment and facilities by biotechnology companies without existing capabilities.

We believe Laureate Pharma's broad range of services and deep development expertise position it to benefit from these trends.

*Services.* Laureate Pharma's services include:

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- **Bioprocessing**, which focuses on clinical stage and small-to medium-sale commercial biopharmaceutical products and comprises the essential steps to support the development and commercialization of customers' products, including:
  - Cell Line Development and Optimization — to improve and maximize protein productivity of production cell lines in optimal growth media; the cell lines in turn produce the product protein.
  - Process Development — to bring the product from clinical laboratory scale to pilot production and on to clinical- and commercial-scale production; essential to make sufficient product to support clinical trials and small-scale commercial production.
  - Purification Development — to design and validate procedures for removal of impurities and purification of products that comply with regulatory requirements.
  - Bioreactor Production — using stirred-tank, disposable bag and hollow-fiber mammalian cell culture bioreactors ranging from 20 to 2,500 liters to produce biopharmaceutical protein products.
  - Downstream Processing — to develop and operate robust purification processes for cGMP manufacture of client's products; Laureate Pharma also performs process validation studies as may be required for client products.
  - Aseptic Filling — aseptic vial filling of biopharmaceutical and drug products in batch sizes up to 10,000 vials or 200 liters of bulk volume.
- **Quality Control**, which includes analytical and microbiology testing of raw materials, in-process and finished products.
- **Quality Assurance**, which includes preparation, control and review of documentation, including standard operating procedures (SOPs), master batch records, test procedures, and specifications. Laureate Pharma reviews and releases all controlled materials, including raw materials, intermediates and products.

*Research and Development.* Laureate Pharma's research and development efforts are focused on improving its technology and developing processes for the manufacture of new products to meet customer requirements. The primary goals are to improve manufacturing processes to reduce costs, improve quality and increase capacity.

*Intellectual Property.* Laureate Pharma relies primarily on know-how in its manufacturing processes and techniques not generally known to other life sciences companies to develop and maintain its market position. Laureate Pharma requires employees to sign confidentiality and other protective agreements where appropriate.

*Sales and Marketing; Customers.* Laureate Pharma provides process development and manufacturing services on a contract basis to biopharmaceutical companies. Laureate Pharma's customers generally include small to mid-sized biotechnology and pharmaceutical companies seeking outsourced bioprocessing manufacturing and development services. Laureate Pharma's customers are often dependent on the availability of funding to pursue drugs that are in early stages of clinical trials, and thus have high failure rates. The loss of one or more customers can result in significant swings in profitability from quarter to quarter and year to year. Although there has been a trend among biopharmaceutical companies to outsource drug production functions, this trend may not continue. Although clients tend to maintain one manufacturer through clinical trial phases and even early commercial production, many of Laureate Pharma's contracts are of short duration. As a result, Laureate Pharma seeks new contracts to sustain its revenue. In 2006, four customers each represented more than 10% of Laureate Pharma's revenues; in 2005, two customers each represented more than 10% of Laureate Pharma's revenue from continuing operations.

*Competition.* Our primary competitors focus on supplying clinical scale contract biopharmaceutical development and manufacturing services to biotechnology companies. Generally, the larger of these competitors focus on larger quantities and scale of manufacturing capacity. Laureate Pharma focuses on process development and manufacturing services for clinical and small- and medium-scale commercial production, and maintains a reputation for regulatory compliance, a commitment to quality and excellent early process development services. Laureate Pharma believes that customers in its target markets display loyalty to their initial services provider.

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Therefore, it may be difficult to generate sales to potential customers who have purchased development and manufacturing services from competitors. To the extent Laureate Pharma is unable to be the first to develop and supply new biopharmaceutical products for its clients, its competitive position may suffer.

*Employees.* At December 31, 2006, Laureate Pharma had 92 full-time employees and believes its employee relations are good.

### *Pacific Title & Art Studio, Inc.*

( **Safeguard Ownership: 100%**)

*Safeguard Opportunity.* We acquired an interest in Pacific Title in 1997 and increased our ownership position over time. Technology has driven fundamental changes in the production and post-production of motion picture and television content, with increased emphasis on special effects, digital color correction, 3D animation and many other sophisticated elements. As a pioneer since 1919 in the development and introduction of new methods, services and technologies, we believe Pacific Title is uniquely positioned to lead the continued expansion of digital technologies. Leveraging state-of-the-art equipment and significant domain expertise, Pacific Title can handle the enormous volume and complex programming needed to meet the often changing and rush delivery needs of its clients.

*General.* Pacific Title ([www.pactitle.com](http://www.pactitle.com)) is a leading provider of a broad range of digital and photo-chemical services for post-production and archival applications in the Hollywood motion picture and television industry. Pacific Title provides a complete array of state-of-the-art digital post-production capabilities both for new releases and restoration of film libraries, leading the transformation from optical, analog image reproduction and processing to more dynamic, cost-effective and flexible digital image processing technologies.

*Strategy.* Pacific Title seeks to meet the high-quality service and technological support needs of motion picture studios and production companies. Pacific Title believes that its past growth and future opportunities are being driven by the following industry trends:

- A shift in demand for original film entertainment content capture and manipulated in digital formats as opposed to analog format;
- The development of new and expanding markets for existing film libraries, including remastering, high resolution scanning, archiving and restoration services.
- Increased demand for innovation and technological advances to support creative vision;
- Expanding application of digital technologies for content manipulation, as well as the anticipated deployment of digital distribution and display technologies (including emerging digital projection); and
- Increasing concern for the preservation, restoration and storage of aging film libraries.

We believe Pacific Title's services and industry stature have well positioned the company to continue its leadership in anticipating and meeting its customers' needs.

*Services.* Pacific Title maintains post-production facilities as components of its full range of integrated services. Pacific Title's customers may choose one, several or all of these services based on their needs from project to project.

*Sales and Marketing; Customers.* Pacific Title markets its services through a combination of industry referrals, formal advertising, trade show participation, special client events, and its Internet website. While it relies primarily on its reputation and business contacts within the industry for the marketing of its services, Pacific Title also maintains a direct sales force to communicate the capabilities and competitive advantages of its services to potential new customers. In addition to its traditional sales efforts directed at those individuals responsible for placing orders, Pacific Title negotiates discounted rates with large volume clients in return for being promoted within the client's organization as an established and accepted vendor. Pacific Title negotiates such agreements periodically with major entertainment studios.

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Pacific Title's clients include Walt Disney Company, 20<sup>th</sup> Century-Fox, Universal Studios, Warner Bros., Sony Pictures Entertainment, Dreamworks SKG, Columbia/Tri-Star and Paramount Pictures, as well as many independent motion picture and television production companies. Pacific Title generally does not have exclusive service agreements with its clients. Because clients generally do not make arrangements with Pacific Title until shortly before its facilities and services are required, Pacific Title usually does not have a significant backlog of service orders. Pacific Title's services are generally offered on an hourly or per unit basis based on volume and client demand. For 2006, three customers each represented more than 10% of Pacific Title's revenues. For the year ended December 31, 2005, four customers each represented more than 10% of Pacific Title's revenues.

*Competition.* Pacific Title operates in a competitive, service-oriented industry. Certain competitors provide many of the services provided by Pacific Title, while others specialize in one or several of these services. Some of these companies have greater financial, operational and marketing resources than Pacific Title. Substantially all of Pacific Title's competitors have a presence in the Hollywood, California area, which is the largest market for Pacific Title's services. Pacific Title believes that it maintains a competitive edge in its market through the quality and scope of the services it provides and its proven tradition of providing timely delivery of these services. Pacific Title believes that prices for its services are competitive within its industry, although some competitors may offer certain of their services at lower rates than Pacific Title. The principal competitive factors affecting this market are reliability, timeliness, quality and price. Pacific Title also competes, to a lesser extent, with the in-house operations of major motion picture studios.

*Seasonality.* Pacific Title's business is subject to substantial variations as a result of seasonality, which the company believes is typical of the film post-production industry. Demand for Pacific Title's service also has been adversely impacted on several occasions in recent years as a result of actual or threatened labor stoppages in its customers' film production industry.

*Employees.* At December 31, 2006, Pacific Title had 131 employees. Approximately 38 employees are represented by the International Alliance of Theatrical and Stage Employees pursuant to a collective bargaining agreement, which expires in July 2009. Pacific Title has never experienced a work stoppage and considers its relations with its employees to be good.

### ***Other Partner Companies and Funds***

In 2006 we added five new partner companies; these partner companies are not consolidated based on the level of our voting interests.

#### ***Advantage Healthcare Solutions, Inc.***

**(Safeguard Ownership: 32%)**

*General.* AHS ([www.ahsnewyork.com](http://www.ahsnewyork.com)) provides advanced medical billing software and services, operating both as a business process outsourcer (BPO) and an applications services provider (ASP). AHS employs proprietary, web-based technology and continuous business process improvement methods to increase the operating efficiencies of medical billing and to improve results for its physician customers.

*Safeguard Opportunity.* The outsourced medical claims billing market is estimated to be approximately \$4 billion and growing. However, despite its size, the market is extremely fragmented, allowing for numerous consolidation opportunities. We believe AHS' proprietary software, coupled with its management team's extensive experience in the healthcare, software and medical claims billing markets, lays the foundation for AHS' continued growth and acquisitions.

#### ***Authentium, Inc.***

**(Safeguard Ownership: 12%)**

*General.* Authentium ([www.authentium.com](http://www.authentium.com)) is a leading developer of security software as a service (SaaS) technologies and systems. Its Extensible Security Platform (ESP) allows users to customize security technologies from Authentium and others (such as antivirus, firewalls, content filtering, and compliance monitoring) into their products and services. Authentium's customers—ISPs, cable companies, carriers and other service providers—in turn distribute these bundled solutions to residential and enterprise customers.

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*Safeguard Opportunity.* As hackers become more sophisticated, the market for IT security has grown and is expected to reach \$10.7 billion by 2009. We believe Authentium's recurring revenue model, coupled with its ability to leverage its customers' sales efforts, provides a good foundation for growth in this market.

### ***NuPathe, Inc.***

**(Safeguard Ownership: 21%)**

*General.* NuPathe ([www.nupathe.com](http://www.nupathe.com)) is a specialty pharmaceutical company focused on acquiring and developing innovative therapeutic products for the treatment of neurological or psychiatric disease. NuPathe's lead product, NP101, is a transdermal patch that delivers the drug sumatriptan for the treatment of migraines. The ability to deliver migraine medication through a fast and long-acting transdermal patch may provide an alternative for the large percentage of migraine patients who suffer from nausea, vomiting or migraine recurrence. Two additional products, NP201 and NP202, are in preclinical development as potential therapies to treat Parkinson's disease and schizophrenia respectively. The development of drug delivery alternatives designed to make current therapies safer and more effective is a core focus of NuPathe's business platform.

*Safeguard Opportunity.* By combining existing drug delivery technology with a market-accepted drug, NuPathe is positioned at a compelling market junction. We believe that NuPathe's approach presents an opportunity to compete effectively in the market for migraine treatments, estimated to exceed \$2 billion.

### ***Portico Systems, Inc.***

**(Safeguard Ownership: 47%)**

*General.* Portico ([www.porticosys.com](http://www.porticosys.com)) is a leading software solutions provider for regional and national health plans looking to optimize provider network operations and streamline business processes. The Portico Provider Platform is a suite of solutions that helps health plans address challenges such as growing healthcare costs, quality, consumerism, competition and regulatory changes while creating an agile infrastructure that lays a foundation for efficiency and flexibility. Portico Provider Platform easily integrates with other plan systems, leading partners, service consultants and complementary solution providers. The Portico Provider Platform streamlines provider network processes and accelerates new revenue streams, enhancing employee effectiveness and optimizing provider relationships.

*Safeguard Opportunity.* There are increasing pressures on health plans to improve operating efficiencies, and their current provider data typically does not provide visibility and detailed analysis. In an effort to address the growing need for data transparency, as well as reduce the estimated \$18 billion in administrative costs from rejected medical claims due to incorrect provider data, health plans are looking to leverage provider network operations as a strategic asset. We believe Portico is well-positioned to assist health plans in streamlining business processes and ensuring timely and accurate information with their innovative software solution, Portico Provider Platform. We believe Portico has a competitive advantage in the healthcare enterprise applications and analytics market and has sizable growth opportunities.

### ***Rubicor Medical, Inc.***

**(Safeguard Ownership: 36%)**

*General.* Rubicor ([www.rubicor.com](http://www.rubicor.com)) develops and distributes technologically advanced, disposable, minimally-invasive, breast biopsy and tumor removal devices. Rubicor's three device (which have received FDA clearance) represent attractive alternatives to existing procedures and technology for breast lesion biopsy and removal. This results in a more accurate assessment of the sample including evaluation of margin and determination of size.

*Safeguard Opportunity.* The innovative concept and design of Rubicor's products makes them an attractive alternative to open surgical biopsy and lesion removal. We estimate the market in which Rubicor competes could be in excess of \$500 million today in the United States. We believe there is an opportunity for physicians using Rubicor technology to improve patient outcomes and move many breast surgeries from the operating room to the doctor's office.

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**Other Partner Companies and Funds .** We hold minority interests in a number of other companies and funds, some of which do not operate in our currently targeted market segments. Following are summary descriptions of some of these companies, none of which are consolidated based on the level of our voting interests.

<u>Company</u>	<u>Description of Business</u>	<u>% Owned By Safeguard</u>
<b>Neuronyx, Inc.</b> (www.neuronyx.com)	Development-stage biopharmaceutical company, developing stem-cell based therapeutic products. Neuronyx leverages the ability of adult bone marrow-derived stem cells to repair, regenerate and remodel tissue in acute and chronic disease settings. Neuronyx is currently in phase I clinical trials for the prevention of heart failure post myocardial infarction.	7%
<b>NexTone Communications, Inc.</b> (www.nextone.com)	Developer of carrier-grade products that provide scalable session management of voice over IP (VoIP) and other real-time services.	17%
<b>PROMODEL Corporation</b> (www.promodel.com)	Combines professional services and innovative technology to deliver business process optimization and decision support solutions to the pharmaceutical, healthcare and manufacturing and logistics industries.	50%
<b>Ventaira Pharmaceuticals, Inc.</b> (www.ventaira.com)	Specialty pharmaceutical company using novel aerosolization technology to develop highly differentiated pharmaceutical products. Ventaira Pharmaceuticals combines novel applications of generic drugs with the superior delivery benefits of its Mystic <sup>TM</sup> inhaled drug delivery technology.	13%

We also participate in earlier stage technology and life sciences development through our interests in several private equity funds. During 2006, we provided a total of \$1.7 million in funding of previously committed capital to these funds. We sold our interests in many of our private equity funds in 2005, and we may continue to opportunistically sell our remaining private equity fund interests.

## FINANCIAL INFORMATION ABOUT OPERATING SEGMENTS

Information on revenues, operating income (loss), net income (loss) from continuing operations and assets for each operating segment of Safeguard's business for each of the three years in the period ended December 31, 2006 is contained in Note 20 to the Consolidated Financial Statements.

## OTHER INFORMATION

The operations of Safeguard and its companies are subject to environmental laws and regulations. Safeguard does not believe that expenditures relating to those laws and regulations will have a material adverse effect on the business, financial condition or results of operations of Safeguard.

## AVAILABLE INFORMATION

All periodic and current reports, registration statements, and other filings that Safeguard is required to file with the Securities and Exchange Commission ("SEC"), including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act, are available free of charge from the SEC's website (<http://www.sec.gov>) or public reference room at 450 Fifth Street N.W., Washington, DC 20549 (1-800-SEC-0330) or through Safeguard's Internet website at <http://www.safeguard.com>. Such documents are available as soon as reasonably practicable after electronic filing of the material with the SEC. Copies of these reports (excluding exhibits) may also be obtained free

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of charge, upon written request to: Investor Relations, Safeguard Scientifics, Inc., 435 Devon Park Drive, Building 800, Wayne, PA 19087.

The internet website addresses for Safeguard and its companies are included in this report for identification purposes. The information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

The following corporate governance documents are available free of charge on Safeguard's website: the charters of our Audit, Compensation and Nominating & Corporate Governance Committees, our Corporate Governance Guidelines and our Code of Business Conduct and Ethics. Copies of these corporate governance documents also may be obtained by any shareholder, free of charge, upon written request to: Corporate Secretary, Safeguard Scientifics, Inc., 435 Devon Park Drive, Building 800, Wayne, Pennsylvania 19087. We also will post on our website any amendments to or waivers of our Code of Business Conduct and Ethics that relate to our directors and executive officers.

### Item 1A. Risk Factors

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

#### Risks Related to Our Business

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

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

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

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

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

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

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

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

- For the twelve months ended December 31, 2006, we consolidated the results of operations of Acsis, Alliance Consulting, Clariant, Laureate Pharma and Pacific Title.
- In October 2006, we completed the sale of Mantas and its results of operations for the periods prior to the sale are presented as discontinued operations in the consolidated financial statements.

***Our partner companies currently provide us with little cash flow from their operations so we rely on cash on hand, liquidity events and our ability to generate cash from capital raising activities to finance our operations.***

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

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

Fluctuations in the market prices of the common stock of our publicly-traded holdings are likely to affect the price of our common stock. The market prices of our publicly-traded holdings have been highly volatile and subject to fluctuations unrelated or disproportionate to operating performance. For example, the aggregate market value of our holdings in Clariant (Nasdaq: CLRT) at December 31, 2006 was approximately \$72.8 million, and at December 31, 2005 was approximately \$44.8 million.

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

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

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

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

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common stock and on our proceeds from such a divestiture. Additionally, we may not be able to take our partner companies public as a means of monetizing our position or creating shareholder value.

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

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

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

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

Our strategy involves creating value for our shareholders by helping our partner companies build value and, if appropriate, accessing the public and private capital markets. Therefore, our success is dependent on the value of our partner companies as determined by the public and private capital markets. Many factors, including reduced market interest, may cause the market value of our publicly traded partner companies to decline. If valuations in the market sectors in which our partner companies participate decline, their access to the public and private capital markets on terms acceptable to them may be limited.

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

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

- the management of a partner company having economic or business interests or objectives that are different than ours; and
- partner companies not taking our advice with respect to the financial or operating difficulties they may encounter.

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

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

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

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compliance with the 40% Test. Consequently, we do not believe that we are an investment company under the Investment Company Act.

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

### **Risks Related to Our Partner Companies**

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

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

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

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

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

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

The technology and life sciences marketplaces are characterized by:

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

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- changing customer demands.

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

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

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

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

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

### ***Our partner companies may need to raise additional capital to fund their operations, which we may not be able to fund or which may not be available from third parties on acceptable terms, if at all.***

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

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

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

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

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

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

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

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

Our partner companies are dependent upon their ability to attract and retain senior management and key personnel, including trained technical and marketing personnel. Our partner companies will also need to continue to hire additional personnel as they expand. Some of our partner companies have employees represented by labor unions. Although these 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.

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

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

### **Item 2. Properties**

Safeguard's corporate headquarters and administrative offices in Wayne, Pennsylvania contain approximately 31,000 square feet of office space in one building. In October 2002, Safeguard sold this facility along with the office park in which our corporate headquarters and administrative offices are located. Safeguard leased back its corporate headquarters for a seven-year term with one five-year renewal option.

Safeguard's consolidated partner companies lease various facilities throughout the United States and in certain non-U.S. locations. The physical properties occupied by each of our consolidated partner companies, under leases expiring between 2007 and 2015, are summarized below:

<u>Company</u>	<u>Locations</u>	<u>Use</u>	<u>Approximate Square Footage</u>
Acsis	New Jersey and Germany	Office/Sales/Development	39,000
Alliance Consulting	Pennsylvania and other locations in the U.S. and India (11 facilities)	Office/Sales/Development	83,000
Clariant	California	Office/Manufacturing/Laboratory Services	78,000
Pacific Title	California (two facilities)	Office/Production	37,000
Laureate Pharma	New Jersey	Office/Manufacturing	58,000

We believe that all of the existing facilities are suitable and adequate to meet the current needs of our respective partner companies. If new or additional space is needed, we believe each of our partner companies can readily obtain suitable replacement properties to support their needs on commercially reasonable terms. However, we note that Clariant's and Laureate Pharma's facilities are operated under and subject to various federal, state and local permits, rules and regulations. As a result, any extended interruption in the availability of these facilities could have a material adverse effect on the results of operations of the respective companies.

### **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.

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

No matter was submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the fourth quarter of 2006.

ANNEX TO PART I — EXECUTIVE OFFICERS OF THE REGISTRANT

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Executive Officer Since</u>
Peter J. Boni	61	President, Chief Executive Officer and Director	2005
James A. Datin	44	Executive Vice President and Managing Director, Life Sciences	2005
John A. Loftus	45	Executive Vice President and Managing Director, Technology	2004
Steven J. Feder	43	Senior Vice President and General Counsel	2004
Stephen T. Zarrilli	45	Acting Senior Vice President, Acting Chief Administrative Officer and Acting Chief Financial Officer	2006

Mr. Boni joined Safeguard as President and Chief Executive Officer 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. Boni is currently non-executive Chairman of Intralinks, Inc. and a director of Clariant, Inc.

Mr. Datin joined Safeguard as Executive Vice President and Managing Director, Life Sciences 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 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. Datin is a director of Intralinks, Inc. and Clariant, Inc.

Mr. Loftus joined Safeguard in May 2002, became Senior Vice President and Chief Technology Officer in December 2003 and Executive Vice President and Managing Director, Technology Group in September 2005. Mr. Loftus is a founder of Gestalt LLC where he served as Chief Technology Officer from September 2001 to May 2002. Mr. Loftus served as Senior Vice President, e-Solutions (and in other executive roles) at Breakaway Solutions from May 1999 until August 2001 (Breakaway Solutions filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code in September 2001); and served as Senior Vice President and Chief Technology Officer of WPL Laboratories from February 1997 to May 1999. Mr. Loftus spent the first 14 years of his career in a variety of executive, management, and engineering positions at GE and PECO Energy.

Mr. Feder joined Safeguard in November 2004 as Senior Vice President and General Counsel. Prior to joining Safeguard, Mr. Feder was a partner with the law firm of Pepper Hamilton LLP in its Berwyn, Pennsylvania office from May 2000 to November 2004. He was a partner from March 1998 to May 2000 at the law firm of White and Williams LLP in Philadelphia, Pennsylvania and a senior associate from July 1995 to March 1998 at the law firm of Ballard Spahr Andrews and Ingersoll in Philadelphia, Pennsylvania. From 1990 to June 1995, Mr. Feder was corporate counsel for MEDIQ Incorporated, formerly an AMEX-listed diversified healthcare company. Mr. Feder is a director of Clariant, Inc.

Mr. Zarrilli entered into a consulting agreement with Safeguard in December 2006 pursuant to which he commenced service as Acting Senior Vice President, Acting Chief Administrative Officer and Acting Chief Financial Officer. Mr. Zarrilli is a Managing Partner of the Penn Valley Group, a middle-market management

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advisory and private equity firm which he co-founded in October 2004. Previously, Mr. Zarrilli served as the Chief Financial Officer from August 2001 to December 2004 of Fiberlink Communications Corporation, a provider of remote access VPN solutions for large enterprises; as the Chief Executive Officer from October 2000 to August 2001 of Concellera Software, Inc., a developer of content management software; as the Chief Executive Officer from January 1999 to September 2000 and Chief Financial Officer from July 1994 to December 1998 of US Interactive, Inc., a provider of internet strategy consulting, marketing and technology services; 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**

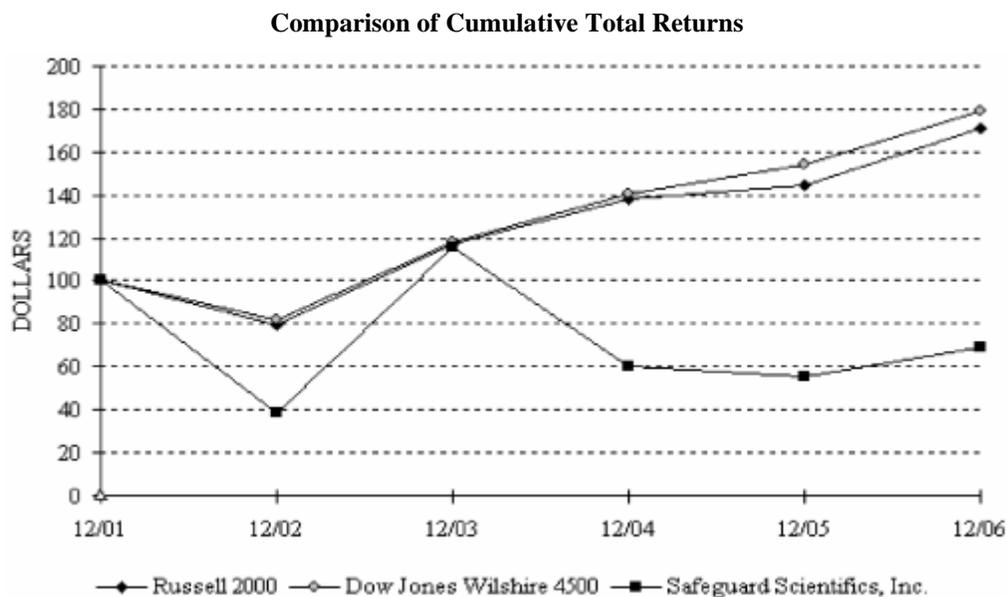
Safeguard’s common stock is listed on the New York Stock Exchange (Symbol: SFE). The high and low sale prices reported within each quarter of 2006 and 2005 are as follows:

	High	Low
<b>Fiscal year 2006:</b>		
First quarter	\$2.57	\$1.77
Second quarter	2.90	1.91
Third quarter	2.30	1.71
Fourth quarter	2.55	1.92
<b>Fiscal year 2005:</b>		
First quarter	\$2.17	\$1.36
Second quarter	1.58	0.98
Third quarter	1.85	1.21
Fourth quarter	2.05	1.31

The high and low sale prices reported in the first quarter of 2007 through March 22, 2007 were \$3.15 and \$2.31, respectively, and the last sale price reported on March 22, 2007, was \$3.02. No cash dividends have been declared in any of the years presented, and Safeguard has no present intention to declare cash dividends.

As of March 22, 2007, there were approximately 44,000 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, 2001 through December 31, 2006 with the cumulative total return on \$100 invested for the same period in the Russell 2000 Index and the Dow Jones 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 Dow Jones 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 Dow Jones Wilshire 4500 indices.



- Assumes reinvestment of dividends. We have not distributed cash dividends during this period.
- Assumes an investment of \$100 on December 31, 2001.

**Item 6. Selected Consolidated Financial Data**

The following table sets forth our selected consolidated financial information for the five-year period ended December 31, 2006. 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. As a result of the sale of Mantas in October 2006, Mantas’ operating results are included in discontinued operations for all periods presented. Alliance Consulting sold its Southwest region business in July 2006; as a result the operations of the Southwest region are included in discontinued operations for all periods presented. As a result of the sale of Laureate Pharma’s Totowa, New Jersey facility in December 2005, the operating results related to its Totowa facility are included in discontinued operations in 2005. As a result of the sale of CompuCom on October 1, 2004, the operating results of CompuCom are included in discontinued operations for 2002 through 2004.

	<b>December 31,</b>				
	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>(In thousands)</b>				
<b>Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 71,251	\$124,916	\$143,398	\$129,676	\$117,326
Short-term investments	94,155	31,770	33,555	7,081	9,986
Restricted cash	—	1,098	1,069	1,019	3,634
Working capital of continuing operations	136,894	145,996	172,737	133,332	121,935
Cash held in escrow	19,630	—	—	—	—
Total assets of continuing operations	443,381	375,344	399,616	329,696	381,565
Long-term debt, net of current portion	3,095	3,041	7,852	2,118	932
Capital leases, net of current portion	1,972	2,129	1,858	409	652
Other long-term liabilities	10,918	14,013	11,785	13,152	14,018
Convertible subordinated notes	—	—	—	200,000	200,000
Convertible senior debentures-non-current	129,000	145,000	150,000	—	—
Total shareholders’ equity	211,881	164,975	201,230	236,171	272,287

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### Consolidated Statements of Operations Data

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands except per share amounts)				
<b>Revenue:</b>					
Product sales	\$ 10,668	\$ 5,898	\$ 2,211	\$ 9,134	\$ 19,298
Service sales	187,392	137,933	107,143	122,170	86,786
Total revenue	198,060	143,831	109,354	131,304	106,084
<b>Operating Expenses:</b>					
Cost of sales — product	7,556	1,921	2,532	10,349	7,005
Cost of sales — service	134,834	103,260	74,882	72,824	40,979
Selling, general and administrative	99,962	74,178	73,053	73,197	94,976
Research and development	6,977	3,794	4,699	6,570	11,041
Purchased in-process research and development	—	2,183	89	265	1,129
Amortization of intangibles	3,413	2,367	2,192	1,976	1,085
Goodwill impairment	—	—	—	15,968	6,575
Total operating expenses	252,742	187,703	157,447	181,149	162,790
Operating loss	(54,682)	(43,872)	(48,093)	(49,845)	(56,706)
Other income (loss), net	5,573	7,338	38,803	48,838	(5,241)
Recovery (impairment) — related party	360	28	(3,400)	(659)	(11,434)
Interest income	6,914	4,984	2,612	2,165	6,313
Interest expense	(6,821)	(6,428)	(9,585)	(11,853)	(21,594)
Equity loss	(3,267)	(6,597)	(14,534)	(17,179)	(51,004)
Minority interest	7,120	6,356	8,736	3,216	6,389
Net loss from continuing operations before income taxes and change in accounting principle	(44,803)	(38,191)	(25,461)	(25,317)	(133,277)
Income tax benefit (expense)	1,023	83	120	(209)	(46)
Net loss from continuing operations before change in accounting principle	(43,780)	(38,108)	(25,341)	(25,526)	(133,323)
Income (loss) from discontinued operations, net of tax	89,810	6,038	(29,479)	(7,805)	4,655
Cumulative effect of change in accounting principle	—	—	—	—	(21,815)
Net income (loss)	\$ 46,030	\$ (32,070)	\$ (54,820)	\$ (33,331)	\$ (150,483)
<b>Basic Income (Loss) Per Share:</b>					
Net loss from continuing operations	\$ (0.36)	\$ (0.32)	\$ (0.21)	\$ (0.22)	\$ (1.13)
Net income (loss) from discontinued operations	0.74	0.05	(0.25)	(0.06)	0.03
Cumulative effect of change in accounting principle	—	—	—	—	(0.18)
Net income (loss)	\$ 0.38	\$ (0.27)	\$ (0.46)	\$ (0.28)	\$ (1.28)
<b>Diluted Income (Loss) Per Share:</b>					
Net loss from continuing operations	\$ (0.36)	\$ (0.32)	\$ (0.21)	\$ (0.22)	\$ (1.16)
Net income (loss) from discontinued operations	0.74	0.05	(0.25)	(0.08)	0.04
Cumulative effect of change in accounting principle	—	—	—	—	(0.18)
Net income (loss)	\$ 0.38	\$ (0.27)	\$ (0.46)	\$ (0.30)	\$ (1.30)
<b>Shares used in computing:</b>					
Basic and diluted income (loss) per share	121,476	120,845	119,965	118,486	117,736

Certain amounts for prior periods in the Consolidated Financial Statements have been reclassified to conform with current period presentations.

### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Cautionary Note concerning Forward-Looking Statements

This report contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about us, the industries in which we operate and other matters, as well as management's beliefs and assumptions and other statements regarding matters that are not historical facts. These statements include, in particular, statements about our plans, strategies and prospects. For example, when we use words such as "projects," "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "should," "would," "could," "will," "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, the ability to execute our strategy, the uncertainty of the future performance of our partner companies, acquisitions and dispositions of interests in partner companies, the inability to manage growth, compliance with government regulation and legal liabilities, additional financing requirements and the effect of economic conditions in the business sectors in which our partner companies operate, all of which are discussed in Item 1A. Business under the caption "Risk Factors." Many of these factors are beyond our ability to predict or control. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this report might not occur. In addition, as a result of these and other factors, our past financial performance should not be relied on as an indication of future performance.

All forward-looking statements attributable to us, or to persons acting on our behalf, are expressly qualified in their entirety by this cautionary statement. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

#### Overview

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

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

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

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

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

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

*Consolidation Method.* Partner companies in which we directly or indirectly own more than 50% of the outstanding voting securities are accounted for under the consolidation method of accounting. Participation of other partner company shareholders in the income or losses of our consolidated partner companies is reflected as Minority Interest in the Consolidated Statements of Operations. Minority interest adjusts our consolidated operating results to

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reflect only our share of the earnings or losses of the consolidated partner company. If there is no minority interest balance remaining on the Consolidated Balance Sheets related to the respective partner company, we record 100% of the consolidated partner company's losses; we record 100% of subsequent earnings of the partner company to the extent of such previously recognized losses in excess of our proportionate share.

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

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

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

### Critical Accounting Policies and Estimates

Accounting policies, methods and estimates are an integral part of 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:

- Revenue recognition;
- Recoverability of long-lived assets;
- Recoverability of goodwill;
- Recoverability of ownership interests in and advances to companies;
- Income taxes;
- Commitments and contingencies; and
- Stock-based compensation.

### Revenue Recognition

During 2006, 2005 and 2004, our revenue from continuing operations was primarily attributable to Acsis (since December 2005), Alliance Consulting, Clariant, Laureate Pharma (since December 2004) and Pacific Title.

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

Acsis recognizes software fees in accordance with Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended. Although Acsis follows specific and detailed guidelines in measuring revenue, the application of those guidelines requires judgment including: (i) whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence of fair value exists for those elements; (ii) whether customizations or modifications of the software are significant; and (iii) whether collection of the software fee is probable. Additionally, Acsis specifically evaluates any other terms in its license transactions, including but not limited to, options to purchase additional software at a future date, extended payment terms and functionality commitments not delivered with the software. Acsis recognizes software license revenue when the following criteria are met: (1) a signed contract is obtained; (2) delivery of the products has occurred; (3) the license fee is fixed or determinable; and (4) collectibility is probable. Acsis generally recognizes license revenue using the "residual method" when there is vendor-specific objective evidence of the fair values of all undelivered elements in a multiple-element arrangement that is not accounted for using long-term contract accounting. For those contracts that contain significant customization or modifications, license revenue is recognized using the percentage-of-completion method.

Most of Acsis' software arrangements include professional services. Acsis provides professional services under service agreements on a time and material-basis or based on a fixed-price arrangement. The revenues from Acsis' time and material-based professional consulting and implementation services are recognized as the work is performed, provided that the customer has a contractual obligation to pay, the fee is non-refundable and collection is probable. Delays in project implementation will result in delays in revenue recognition. Acsis recognizes revenues from professional consulting services under fixed-price arrangements, using the proportional-performance method based on direct labor costs incurred to date as a percentage of total estimated labor costs required to complete the project. Revisions to the estimates are reflected in the period in which changes become known. Project losses are provided for in their entirety in the period they become known, without regard to the percentage-of-completion. If Acsis does not accurately estimate the resources required or the scope of work to be performed, or if Acsis does not manage their projects properly within the planned periods of time, then future consulting margins on its projects may be negatively affected or losses on existing contracts may need to be recognized.

Hardware revenue is generated from the resale of a variety of hardware products, developed and manufactured primarily by third parties, which are integrated with and complementary to Acsis' software solutions. These products include computer equipment, RFID chip readers, bar code printers and scanners and other peripherals. Acsis generally purchases hardware from vendors only after receiving an order from a customer, and revenue is recognized upon shipment by the vendor to the customer unless the hardware is an element in an arrangement that includes services that involve significant customization or modifications to software, in which case, hardware revenue is bundled with the software and services are recognized on a percentage-of-completion basis.

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

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

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Clariant recognizes revenue for fee-per-use agreements based on the greater of actual usage fees or the minimum monthly rental fee. Under this pricing model, Clariant owns most of the ACIS instruments that are engaged in service and, accordingly, all related depreciation and maintenance and service costs are expensed as incurred.

Revenue for instruments that are sold is recognized and deferred using the residual method pursuant to the requirements of SOP 97-2, as amended by Statement of Position No. 98-9, "Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Arrangements." At the outset of the arrangement with the customer, Clariant defers revenue for the fair value of its undelivered elements (e.g., maintenance) and recognizes revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (e.g., software license) when the basic criteria in SOP 97-2 have been met. Maintenance revenue is recognized ratably over the term of the maintenance contract, typically twelve months.

Systems sold under a leasing arrangement are accounted for as sales-type leases pursuant to SFAS No. 13, "Accounting for Leases," if applicable. Clariant recognizes the net effect of these transactions as a sale because of the bargain purchase option granted to the lessee.

Clariant has entered into a distribution and development agreement with Dako, which includes multiple elements. Those elements include distribution rights, ACIS instruments, research and development services, training and maintenance. The agreement calls for an upfront payment and additional payments as instruments are delivered or milestones are achieved under the research and development component. Clariant accounts for this arrangement under the percentage-of-completion method using the zero profit margin approach. Under this approach, revenue is recognized in amounts equal to the costs incurred to provide the products and services. Clariant further limits the amount of revenue recognized to the amount of fees that are fixed or determinable under the agreement. Because Clariant does not have evidence of fair value for certain elements that span the term of the agreement, the profit earned will be recognized over the remaining term of the agreement once the research and development services are complete. As of December 31, 2006, the research and development services were ongoing.

On March 8, 2007, Clariant sold its technology group business (which developed, manufactured and marketed the ACIS Automated Image Analysis System) and related intellectual property to Zeiss MicroImaging, Inc.

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

Pacific Title's revenue is primarily derived from providing archival and post-production services to the motion picture and television industry. Pacific Title recognizes revenue generally upon the performance of services. Pacific Title performs certain services under fixed-price contracts. Revenue from these contracts is recognized on a percentage-of-completion basis based on costs incurred to total estimated costs to be incurred. Changes in the estimates of total cost could result in changes in the amount of revenue recognized. Any anticipated losses on contracts are expensed when identified.

### ***Recoverability of Long-Lived Assets***

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

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undiscounted cash flows are not sufficient to recover the carrying value, we measure any impairment loss as the excess of the carrying amount of the asset over its fair value.

The carrying value of net intangible assets at December 31, 2006 was \$16 million. The carrying value of net property and equipment at December 31, 2006 was \$45 million.

### ***Recoverability of Goodwill***

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

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

The carrying value of goodwill at December 31, 2006 was \$82 million.

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

### ***Recoverability of Ownership Interests In and Advances to Companies***

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

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

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

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

Total impairment charges related to ownership interests in and advances to companies are included in the following table:

<u>Accounting Method</u>	<u>Year Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Equity	\$ —	\$ — (in millions)	\$ 3.7
Cost	—	1.4	3.2
Total	<u>\$ —</u>	<u>\$ 1.4</u>	<u>\$ 6.9</u>

Impairment charges related to equity method companies are included in Equity Loss in the Consolidated Statements of Operations. Impairment charges related to cost method companies are included in Other Income, Net in the Consolidated Statements of Operations.

### *Income Taxes*

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

### *Commitments and Contingencies*

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

### *Stock-Based Compensation*

As permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," prior to January 1, 2006, we accounted for employee stock-based compensation in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation expense was recorded for stock options issued to employees at fair market value.

On January 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"). SFAS No. 123(R) requires companies to measure all employee stock-based compensation awards using a fair value

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method and record such expense in its consolidated financial statements. We adopted SFAS No. 123(R) using the modified prospective method. Accordingly, prior period amounts have not been restated. Under this application, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

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

### Results of Operations

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

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

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

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

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

	Year Ended December 31,		
	2006	2005 (In thousands)	2004
Acsis	\$ (8,264)	\$ (2,556)	\$ —
Alliance Consulting	127	(1,194)	(7,736)
Clariant	(9,587)	(9,717)	(12,829)
Laureate Pharma	(9,737)	(10,870)	(270)
Pacific Title	2,384	3,748	1,157
Other companies	(2,455)	(791)	26,157
Total segments	<u>(27,532)</u>	<u>(21,380)</u>	<u>6,479</u>
Other items:			
Corporate operations	(17,271)	(16,811)	(31,940)
Income tax benefit	1,023	83	120
Total other items	<u>(16,248)</u>	<u>(16,728)</u>	<u>(31,820)</u>
Net loss from continuing operations	(43,780)	(38,108)	(25,341)
Income (loss) from discontinued operations, net of taxes	89,810	6,038	(29,479)
Net income (loss)	<u>\$ 46,030</u>	<u>\$(32,070)</u>	<u>\$(54,820)</u>

Included in the above was stock-based compensation expense, which for the year ended December 31, 2006 reflected the adoption of SFAS No. 123(R) as follows:

	Stock-Based Compensation Year Ended December 31,		
	2006	2005 (In thousands)	2004
Acsis	\$ 208	\$ —	\$ —
Alliance Consulting	1,016	329	578
Clariant	1,277	516	614
Laureate Pharma	165	—	—
Pacific Title	139	555	787
Total segment results	2,805	1,400	1,979
Other items (corporate operations)	4,037	1,265	2,273
	<u>\$ 6,842</u>	<u>\$ 2,665</u>	<u>\$ 4,252</u>

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

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### Acsis

We acquired 94% of Acsis in December 2005. Results for the year ended December 31, 2005 include only the period from acquisition (December 2, 2005) through December 31, 2005. Accordingly, the discussion of Acsis' results of operations compares the quarter ended December 31, 2006 with the quarter ended September 30, 2006.

	<u>Year Ended December 31,</u>		<u>Quarter Ended</u>	<u>Quarter Ended</u>
	<u>2006</u>	<u>2005</u>	<u>December 31,</u>	<u>September 30,</u>
	<u>(In thousands)</u>		<u>(In thousands)</u>	
Revenue	\$18,634	\$ 2,022	\$ 5,493	\$ 4,156
Operating expenses:				
Cost of sales	13,239	1,689	3,990	2,755
Selling, general and administrative	10,182	688	2,474	2,930
Research and development	2,501	124	804	616
Purchased in-process research and development	—	1,974	—	—
Amortization of intangibles	1,488	126	345	383
Total operating expenses	<u>27,410</u>	<u>4,601</u>	<u>7,613</u>	<u>6,684</u>
Operating loss	(8,776)	(2,579)	(2,120)	(2,528)
Interest, net	101	2	32	59
Minority interest	411	21	87	111
Net loss before income taxes	<u>\$ (8,264)</u>	<u>\$ (2,556)</u>	<u>\$ (2,001)</u>	<u>\$ (2,358)</u>

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

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

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

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

In June 2006, Safeguard acquired additional common shares of Acsis for an aggregate purchase price of \$6 million in cash increasing our ownership to 96%. We funded Acsis to support its long-term growth strategy.

At December 31, 2006, we owned a 96% voting interest in Acsis.

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### Revenue.

*Quarter December 31, 2006 vs. September 30, 2006* . Revenue increased \$1.3 million, or 32.2%, in the fourth quarter of 2006 as compared to the third quarter of 2006. The increase was primarily due to a \$1.4 million increase in hardware sales. Hardware sales fluctuate significantly from period to period given the timing of customer orders. With the launch of three new software products in the second and third quarters of 2006 and six new license agreements signed in the fourth quarter, Acsis expects license and services revenue to increase in 2007.

Acsis' top five customers accounted for approximately 55% of total revenue for the year ended December 31, 2006. Two customers each accounted for more than 10% of total revenue for the year ended December 31, 2006.

### Operating Expenses.

*Quarter December 31, 2006 vs. September 30, 2006*. Operating expenses increased \$0.9 million, or 13.9%, in the fourth quarter of 2006 as compared to the third quarter of 2006. Gross margins decreased to 27.4% for the fourth quarter of 2006, from 33.7% in the third quarter of 2006. The decrease was due to the implementation of several projects of Acsis' new offerings requiring more labor hours than anticipated. Selling, general and administrative expense decreased \$0.5 million or 15.5% for the fourth quarter of 2006 as compared to the third quarter of 2006 due to severance costs included in the third quarter of \$0.5 million. Excluding these costs, selling, general and administrative costs were consistent from the third quarter of 2006 to the fourth quarter of 2006. Research and development expense increased \$0.2 million or 30.5% in the fourth quarter as compared to the third quarter of 2006. Acsis expects research and development costs to increase in future periods as it continues to develop new products.

Acsis anticipates the addition of management resources and new sales and product initiatives during 2006 to assist in growth. As a result of these strategies, Acsis expects continued losses in 2007.

Included in operating expenses in 2005 was \$2.0 million associated with an in-process research and development charge related to the acquisition of Acsis in December 2005. The amount of the charge was determined by management, which utilized a third party valuation firm to assist in the valuation of Acsis' in-process research and development.

### Alliance Consulting

We acquired Alliance Consulting in December 2002. The financial information presented below does not include the results of operations of Alliance Consulting's Southwest region business, which was sold in May 2006 and is included in discontinued operations for all periods presented. Alliance Consulting completed the sale of that business during the second quarter of 2006, which resulted in a net gain of \$1.6 million. For the years ended December 31, 2006, 2005 and 2004, the Southwest region generated revenue of \$3.1 million, \$11.2 million and \$21.3 million and net income of \$1.6 million (including the gain on the sale of \$1.6 million), \$0.9 million and \$2.2 million, respectively.

	Year Ended December 31,		
	2006	2005	2004
Revenue	\$104,571	\$ 82,604	\$ 71,814
Operating expenses:			
Cost of sales	73,837	57,030	50,193
Selling, general and administrative	28,916	25,030	28,468
Amortization of intangibles	1,010	966	592
Total operating expenses	103,763	83,026	79,253
Operating income (loss)	808	(422)	(7,439)
Other income (loss), net	157	(7)	35
Interest, net	(818)	(771)	(356)
Minority interest	(20)	6	24
Net income (loss) from continuing operations before income taxes	\$ 127	\$ (1,194)	\$ (7,736)

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

Alliance Consulting's fiscal year generally consists of a 52-week period and periodically consists of a 53-week period because the fiscal year ends on the Saturday closest to December 31. Fiscal years 2006, 2005 and 2004 ended on December 30, 2006, December 31, 2005 and January 1, 2005, respectively. Fiscal year 2004 was a 53-week period. References to a year included in this section refer to a fiscal year rather than a calendar year.

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

In July 2006, Alliance Consulting completed the purchase of specific assets and assumed certain liabilities of Fusion Technologies, Inc., ("Fusion") a provider of strategic information technology solutions to rapidly growing organizations within the United States. In October 2004, Alliance Consulting acquired Mensamind, Inc. ("Mensamind"), a software development company based in Hyderabad, India. These acquisitions provided Alliance Consulting substantial offshore capabilities for new and existing clients.

At December 31, 2006, we owned 99% of Alliance Consulting.

### *Year Ended December 31, 2006 Versus 2005*

*Revenue* . Revenue, including reimbursement of expenses, increased \$22.0 million, or 26.6% in 2006 as compared to the prior year. This increase was due to the Fusion acquisition in July 2006 of approximately \$7.8 million, growth in existing accounts as well as the development of new key accounts; plus the expansion of Alliance Consulting's Outsourcing, Master Data Management and Global Delivery services. In Outsourcing engagements, Alliance Consulting assumes responsibility for managing a client's business applications with the goal of improving reliability and performance of those applications while reducing costs. Master Data Management includes business intelligence and data management as well as corporate performance management. Global Delivery is Alliance Consulting's high quality, lower-priced offshore delivery and support service. Revenue from these services was \$32.4 million for 2006 as compared to \$24.8 million for 2005.

Alliance Consulting's top ten customers accounted for approximately 56% of total revenue in 2006 and approximately 60% of total revenue in 2005. The same two customers each represented more than 10% of total revenue for the years ended December 30, 2006 and December 31, 2005.

Revenue growth is expected in 2007 from further penetration of existing accounts, newly developed accounts and those from the Fusion acquisition. Alliance Consulting will continue to leverage its Outsourcing, Master Data Management and Global Delivery capabilities to facilitate growth in all of its vertical market sectors. Clients continue to award projects in multiple phases resulting in extended sales cycles and gaps between phases. Alliance Consulting must also compete against larger IT services companies with greater resources and more developed offshore delivery organizations.

*Cost of Sales*. Cost of sales increased \$16.8 million, or 29.5% in 2006 as compared to the prior year. This increase was primarily a result of growth in revenues. Gross margin declined from 31.0% in 2005 to 29.4% in 2006

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primarily due to an increase in reimbursable expenses, cost over-runs on certain fixed fee engagements and higher staffing costs; partially offset by the addition of higher-margin engagements from the Fusion acquisition.

Alliance Consulting expects gross margins to continue to be affected by general economic uncertainty, increases in overall pricing pressures within the industry, discounts required for longer-term engagements, increased employee and contractor costs resulting from greater competition within the talent pool due to declining unemployment levels, wage inflation in India as the demand for those resources increases, resource availability, ability to retain key resources and efficiency in project management.

*Selling, General and Administrative.* Selling, general and administrative expenses increased \$3.9 million, or 15.5% in 2006 as compared to the prior year. Selling, general and administrative expenses were 27.7% of revenue in 2006 as compared to 30.3% of revenue in 2005. The increase in dollars was primarily from the addition of Fusion selling, general and administrative expenses of approximately \$2.0 million, incremental stock-based compensation charges of approximately \$0.7 million due to the adoption of SFAS No. 123(R), an increase in variable compensation due to growth in revenues, a restructuring charge of \$0.5 million taken to consolidate multiple facilities within the same market, recruitment fees of \$0.2 million associated with expanding the sales organization and \$0.2 million associated with expanding existing facilities, primarily in India. The decrease as a percentage of revenue was due to the company's fixed costs and benefits from cost savings initiatives during the year.

Selling, general and administrative costs are expected to increase as Alliance Consulting's business continues to grow. As a percentage of revenue, however, costs are expected to decrease as certain costs are not expected to recur and certain costs are fixed. Alliance Consulting also expects to continue realizing benefits from cost savings initiatives and realignment of support and sales positions made throughout the year.

*Interest, Net .* Interest expense remained relatively flat in 2006 as compared to 2005, as a result of higher interest rates partially offset by lower outstanding debt balances during the year.

*Net Income (Loss) Before Income Taxes.* Net income for the year ended December 31, 2006 was \$0.1 million compared to net loss of \$1.2 million in 2005 due to growth in revenues, benefits from cost saving initiatives and the Fusion acquisition; partially offset by the decline in gross margins, restructuring expenses incurred and incremental stock-based compensation expense due to the adoption of SFAS No. 123(R).

### *Year Ended December 31, 2005 Versus 2004*

*Revenue .* Revenue, including reimbursement of expenses, increased \$10.8 million, or 15.0% in 2005 as compared to 2004. This increase was due to growth in existing accounts as well as the development of new key accounts, expansion of Alliance Consulting's outsourcing services and new service offerings introduced in 2004, Master Data Management and Global Delivery. Revenue associated with these new services generated an aggregate of \$10.9 million during 2005 as compared to \$2.0 million in 2004.

*Cost of Sales.* Cost of sales increased \$6.8 million, or 13.6% in 2005 as compared to 2004. This increase was primarily a result of growth in revenues. Gross margin improved from 30.1% in 2004 to 31.0% in 2005 due to a shift in product mix more towards higher value, higher margin business, including Master Data Management and Global Delivery, and less reimbursable expenses combined with improvements in project management as well as improved utilization. Partially offsetting these improvements were discounts of \$0.4 million made to customers in exchange for multi-year engagements.

*Selling, General and Administrative.* Selling, general and administrative costs decreased \$3.4 million, or 12.1% in 2005 as compared to 2004. Selling, general and administrative expenses were 30.3% of revenue in 2005 as compared to 39.6% of revenue in 2004. The decrease in dollars was due to the cost savings associated with reducing the non-billable workforce during 2004 and 2005, transitioning certain support functions to Alliance Consulting India, relocating Alliance Consulting's corporate headquarters and staffing other sales offices appropriately to accommodate existing and projected staffing needs, and decreased depreciation because more assets became fully-depreciated during 2004 and 2005 without offsetting capital expenditures being made. Alliance Consulting's 2004 selling, general and administrative also included non-capitalizable expenses associated with the Mensamind acquisition of \$0.9 million, severance associated with former

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executives, a restructuring charge relating to the buy out provisions of the Corporate facility and higher non-cash compensation costs for certain other executives. Offsetting these savings were incremental costs associated with recognizing a full year's costs from the Mensamind acquisition, severance relating to a senior manager and increased variable compensation directly related to the improved financial performance as compared to 2004.

*Amortization.* Amortization expense associated with amortizable intangible assets increased \$0.4 million or 63.2% to \$1.0 million in 2005 as compared to \$0.6 million in 2004. The increase was due to a full year of amortization expenses in 2005 of intangible assets as a result of Alliance Consulting's acquisition of Mensamind during October 2004.

*Interest, Net .* Interest expense increased \$0.4 million or 116.6% in 2005 as compared to 2004. Alliance Consulting attributes the increase to an increase in the average outstanding balances under Alliance Consulting's facility as well as increased interest rates on outstanding borrowings.

*Net Loss Before Income Taxes.* Net loss decreased \$6.5 million, or 84.6% in 2005 as compared to 2004. The improvement was directly related to the growth in higher margin revenue and the decrease in selling, general and administrative expenses.

## Clariant

	Year Ended December 31,		
	2006	2005	2004
Revenue	\$ 33,605	\$ 20,150	\$ 9,769
Operating expenses:			
Cost of sales	17,808	11,254	7,486
Selling, general and administrative	26,013	19,723	17,728
Research and development	4,476	3,670	4,101
Purchased in-process research and development	—	209	89
Amortization of intangibles	915	1,275	1,339
Total operating expenses	49,212	36,131	30,743
Operating loss	(15,607)	(15,981)	(20,974)
Other loss	(39)	—	—
Interest, net	(670)	(180)	(93)
Minority interest	6,729	6,444	8,238
Net loss before income taxes	\$ (9,587)	\$ (9,717)	\$ (12,829)

Clariant is a comprehensive cancer diagnostics company providing cellular assessment and cancer characterization to community pathologists, academic researchers, university hospitals and biopharmaceutical companies. Clariant addresses these customers' needs by leveraging its proprietary bright field microscopy technology to provide precise, reproducible results that targeted cancer therapies and drug discovery efforts require. Clariant leverages ACIS to provide a broad range of oncology testing services (for community pathologists focused on cancer diagnosis and prognosis) and biopharmaceutical services (in support of companies and researchers developing new cancer therapies).

Clariant generates revenue from diagnostic services, system sales and fee-per-use charges.

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The decision to provide in-house laboratory services was made in 2004 to give Clariant an opportunity to capture a significant service-related revenue stream over the much broader and expanding cancer diagnostic testing marketplace while also optimizing the level of service and accuracy provided to remote pathology customers. Clariant believes that they are positioned to participate in this growth because of their proprietary analysis capabilities, depth of experience of the staff in their diagnostic laboratory, relationships with the pharmaceutical companies, and demonstrated ability to develop unique assays to support new diagnostic tests.

Clariant operates primarily in two businesses: 1) the services group which delivers critical oncology testing services to community pathologists, biopharmaceutical companies and other researchers; and 2) the technology group which is engaged in the development, manufacture and marketing of an automated cellular imaging system that is designed to assist physicians in making critical medical decisions.

In September 2006, Clariant completed its acquisition of Trestle Holdings, Inc. (“Trestle”) and Trestle Acquisition Corp. (a wholly-owned subsidiary of Trestle). The purchase strategically positioned Clariant as a leading provider in the anatomical pathology market integrating image analysis, high-speed scanning capabilities and virtual microscopy into one offering. In September 2006, Safeguard acquired additional common shares of Clariant for \$3.0 million, increasing our ownership to 60%. Clariant used the proceeds to support its acquisition of Trestle.

On March 8, 2007, Clariant sold its technology group business (which developed, manufactured and marketed the ACIS Automated Image Analysis System) and related intellectual property to Zeiss MicroImaging, Inc. (the “ACIS Sale”) for an aggregate purchase price of \$12.5 million (including \$1.5 million in contingent purchase price).

As of December 31, 2006, we owned a 60% voting interest in Clariant.

### *Year Ended December 31, 2006 Versus 2005*

**Revenue.** Revenue increased \$13.5 million, or 66.8%, in 2006 as compared to 2005. Revenue from Clariant’s service group increased \$16.5 million, or 144%, from \$11.4 million in 2005 to \$27.9 million in 2006. This increase resulted from the execution of Clariant’s marketing and sales strategy to increase Clariant’s sales to new customers and to enter into new managed care contracts. This increase was also driven by increasing the number of available tests being performed that include immunohistochemistry, flow cytometry and florescent in-situ hybridization (FISH). Clariant anticipates that diagnostic services revenues will continue to increase as a result of increased revenue from existing customers, additional penetration of new customers (including managed care providers) by Clariant’s sales force and its offering of a more comprehensive suite of advanced cancer diagnostics.

Partially offsetting the increase in revenues from the services group was a decline of \$3.0 million in the technology group. The change was primarily the result of a decrease in instrument systems revenue from \$4.4 million in 2005 to \$2.0 million in 2006, a decrease of 53%, and a decline in per click revenue of \$1.5 million from \$4.0 million in 2005 to \$2.5 million in 2006, a decrease of 38%. The decline was partially offset by an increase in development revenue in 2006 of \$1.2 million compared to \$0.4 million in 2005.

**Cost of Sales.** Cost of sales increased \$6.6 million, or 58.2%, in 2006 as compared to 2005. Cost of sales for the services group in 2006 was \$15.6 million compared to \$8.8 million in 2005. Gross margins for Clariant’s services group for 2006 were 44% compared to 23% in 2005. The increase in gross margin in 2006 was attributable to achieving economies of scale in Clariant’s diagnostic laboratory operations. Clariant anticipates similar gross margin results for 2007.

Cost of sales in the technology group was \$2.2 million in 2006 as compared to \$2.4 million in 2005. Gross margins for Clariant’s technology group were 62% in 2006 and 72% in 2005. The decrease in gross margin was a result of lower than expected sales volume combined with the anticipated lower per-system sales price as Clariant moved to its distributor sales arrangement with Dako.

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*Selling, General and Administrative.* Selling, general and administrative expenses increased \$6.3 million, or 31.9%, in 2006 as compared to 2005. Expenses related to both selling, general and administrative and diagnostic services administration are included in this category. Selling, general and administrative expenses for 2006 increased approximately \$3.6 million, or 27.0%, to \$17.0 million as compared to \$13.4 million for the comparable period in 2005. The increase in expenses in 2006 was primarily due to increases in rent expense related to Clariant's new facility, increases in selling expenses to support the growing diagnostics services business, higher stock-based compensation expense due to the implementation of SFAS No. 123(R) and relocation and recruiting expenses. Clariant anticipates sales expense to support its growing diagnostics services business will continue to grow in 2007, and expects general and administrative expenses to decline as a percentage of revenues as Clariant's infrastructure costs stabilize.

Also contributing to the overall increase in selling, general and administrative expenses was diagnostic services administration expenses, which were \$9.0 million in 2006 as compared to \$6.3 million in 2005. The increase was primarily due to higher collection costs due to an increase in services group revenue for the period, and the addition of medical and administrative staff to support this rapidly growing segment of Clariant's business. Clariant expects these costs to continue to increase due to higher collection costs on an anticipated continued increase in services group revenue.

*Research and Development.* Research and development expenses increased \$0.8 million, or 22.0%, in 2006 as compared to 2005. This increase was primarily attributable to personnel and consultants supporting the development activity under Clariant's agreement with Dako and the addition of employees from the Trestle acquisition. While development expenses were higher, Clariant earned development fees under the terms of its distribution and development agreement with Dako, which were recognized in revenue. As a result of the ACIS Sale, Clariant expects research and development expenses to decline substantially in 2007.

*Net Loss Before Income Taxes .* Net loss decreased \$0.1 million, or 1.3%, in 2006 as compared to 2005. The improvement was related to increases in revenue and improved gross margin in the services group, partially offset by increases in selling, general and administrative expenses and research and development expenses.

### *Year Ended December 31, 2005 Versus 2004*

*Revenue.* Revenue increased \$10.4 million, or 106.3%, in 2005 as compared to 2004. Clariant attributes this increase to its diagnostic services offerings, which totaled \$11.4 million in 2005 compared to \$2.2 million in 2004, when Clariant first began to offer its laboratory services. Revenue generated from system sales increased \$2.6 million in 2005 as compared to 2004. A total of 44 ACIS systems were sold in 2005 as compared to 12 system sales in 2004. The increases were partially offset by a decline in fee-per-use revenue caused by a reduction in the aggregate of ACIS placements as a result of customers electing to purchase the equipment following the expiration of their lease and certain customers returning their ACIS equipment in order to utilize the services of Clariant's diagnostic services laboratory.

*Cost of Sales.* Cost of sales increased \$3.8 million or 50.3% in 2005 as compared to 2004. Clariant attributes this increase primarily to cost of sales related to diagnostic services, which was \$8.8 million in 2005. These services commenced late in the second quarter of 2004. Costs were approximately 77% of diagnostic services revenue in 2005, producing a gross margin of 23%. Cost of sales related to system sales and fee-per-use declined in 2005 as compared to 2004. Gross margins for instrument systems were 72% in 2005 as compared to 52% in 2004. The improvement was due primarily to lower costs for systems sold, which in many cases were refurbished older systems and also due to lower costs of field service.

*Selling, General and Administrative.* Selling, general and administrative costs increased \$2.0 million or 11.3% in 2005 as compared to 2004. Clariant attributes this increase primarily to diagnostic services administration. The expense was \$2.8 million higher in 2005 as compared to 2004. Partially offsetting this increase was a decrease due to higher expenses in the prior year from non-cash compensation charges related to stock options and restricted stock, outside consulting costs for interim CEO management services, and the reduction of personnel as a result of the fourth quarter 2004 workforce reduction.

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*Research and Development.* Research and development costs decreased \$0.4 million or 10.5% in 2005 as compared to 2004. Clariant attributes the decline primarily to the reduction in personnel that resulted from its fourth quarter 2004 workforce reduction.

*Net Loss Before Income Taxes .* Net loss before income taxes decreased \$3.1 million or 24.3% in 2005 as compared to 2004. The decline was primarily attributable to the reasons discussed above, partially offset by a \$1.8 million decline in minority interest.

### Laureate Pharma

We acquired 100% of Laureate Pharma in December 2004. Results for the year ended December 31, 2004 include only the period from acquisition (December 3, 2004) through December 31, 2004. The financial information presented below does not include the results of operations of the Totowa facility, which was sold in December 2005 and is included in discontinued operations. For the year ended December 31, 2005, the Totowa operation generated revenue of \$3.5 million and net income of \$5.4 million, including a gain on the sale of \$7.7 million.

	Year Ended December 31,		
	2006	2005 (In thousands)	2004
Revenue	\$11,714	\$ 7,709	\$ 884
Operating expenses:			
Cost of sales	16,060	13,919	842
Selling, general and administrative	4,783	4,261	293
Total operating expenses	20,843	18,180	1,135
Operating loss	(9,129)	(10,471)	(251)
Interest, net	(608)	(399)	(19)
Net loss from continuing operations before income taxes	\$ (9,737)	\$ (10,870)	\$ (270)

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

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

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

In 2006, Laureate Pharma began an expansion of its biopharmaceutical manufacturing facility to increase capacity and broaden its service offerings.

As of December 31, 2006, we owned a 100% voting interest in Laureate Pharma.

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### Year Ended December 31, 2006 Versus 2005

**Revenue.** Revenue increased \$4.0 million, or 52.0%, in 2006 as compared to 2005. The increase was primarily due to \$4.3 million in increased revenues from new client contracts. Laureate Pharma expects revenue to increase in 2007 due to new client contracts.

Four customers each represented more than 10% of total revenue for the year ended December 31, 2006. Two customers each represented more than 10% of Laureate Pharma's revenue from continuing operations for the year ended December 31, 2005.

**Cost of Sales.** Cost of sales increased \$2.1 million, or 15.4%, in 2006 as compared to 2005 primarily due to increased materials and lab supplies of \$1.1 million and increased staffing costs of \$1.3 million to support continued revenue growth, partially offset by lower operating expenses of \$0.2 million. Cost of sales is expected to increase in 2007 due to the expected growth in revenue.

**Selling, General and Administrative.** Selling, general and administrative expense increased \$0.5 million, or 12.2%, in 2006 as compared to 2005 due to increased staffing and stock-based compensation of \$0.2 million. Selling, general and administrative expenses are expected to increase in 2007 due to additional headcount and marketing expenses.

**Net Loss Before Income Taxes .** Net loss decreased \$1.1 million, or 10.4%, in 2006 as compared to 2005. The decline in net loss was primarily attributable to the increase in revenue in 2006.

### Year ended December 31, 2005.

**Revenue .** Revenue in the fourth quarter of 2005 increased by \$0.4 million or 37.3% as compared to revenue in the third quarter of 2005 of \$1.1 million. Laureate Pharma attributes this increase to a new client contract beginning in the fourth quarter, partially offset by the cancellation and timing delays related to other customers.

**Operating Expenses.** Operating expenses increased \$0.5 million or 11.3% in the fourth quarter of 2005 as compared to operating expenses in the third quarter of 2005 of \$4.1 million. Laureate Pharma attributes the increase primarily to increased personnel added in the fourth quarter.

## Pacific Title

	Year Ended December 31,		
	2006	2005	2004
Revenue	\$ 29,536	\$ 31,346	\$ 25,609
Operating expenses:			
Cost of sales	21,446	21,289	18,691
Selling, general and administrative	5,722	6,413	5,692
Total operating expenses	27,168	27,702	24,383
Operating income	2,368	3,644	1,226
Other income, net	14	272	81
Interest, net	2	(53)	(40)
Minority interest	—	(115)	(110)
Net income before income taxes	\$ 2,384	\$ 3,748	\$ 1,157

Pacific Title is a leading provider of a broad range of digital and photo-chemical services for post-production and archival applications in the Hollywood motion picture and television industry. Pacific Title provides a complete array of state-of-the art digital post-production capabilities both for new releases and restoration of film libraries, leading the transformation from optical, analog image reproduction and processing with digital image processing technologies, which we believe is more cost-effective and flexible. In 2005, Pacific Title introduced YCM, which is

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a proprietary method of archiving films, involving the transfer of the film to three color strips: (yellow, cyan and magenta), which can be stored for 100 years.

As of December 31, 2006, we owned a 100% voting interest in Pacific Title.

### *Year Ended December 31, 2006 Versus 2005*

*Revenue.* Revenue decreased \$1.8 million, or 5.8%, in 2006 as compared to 2005. The decrease was due to decreased visual effects revenue of \$2.1 million, trailer revenues of \$1.9 million and scan and record revenues of \$1.5 million, partially offset by increases in digital intermediate and YCM archiving revenue of \$3.8 million. The lower trailer revenues were due to the loss of a large client, while the reduction in visual effects work related to a second half slow down within the industry. Increased revenues from the first full year of digital intermediate and YCM film archiving services partially offset some of the decline.

In 2006, three customers each represented more than 10% of Pacific Title's revenue, compared to four customers in 2005.

*Cost of Sales.* Cost of sales increased \$0.2 million, or 0.7%, in 2006 as compared to 2005 despite the decrease in revenues. The increase was primarily attributable to increased staffing and wages and benefits as well as \$0.2 million in incremental costs associated with the YCM business. These increases were offset by \$0.6 million in equipment lease costs related to leases that had expired. Pacific Title expects margins to improve modestly in 2007 due to product mix and certain cost control measures put in place in the fourth quarter of 2006.

*Selling, General and Administrative.* Selling, general and administrative expense decreased \$0.7 million, or 10.8%, in 2006 as compared to 2005. The decline was primarily due to a \$0.5 million reduction in management incentive bonuses and a \$0.4 million reduction in deferred stock unit amortization expense.

*Net Income before Income Taxes.* Net income declined \$1.4 million, or 36.4%, in 2006 as compared to 2005. The decline was primarily due to the decline in revenues and increased cost of sales, partially offset by the decreases in selling, general and administrative expense.

### *Year Ended December 31, 2005 Versus 2004*

*Revenue.* Total revenue increased \$5.7 million or 22.4% to \$31.3 million in 2005 as compared to \$25.6 million in 2004. Pacific title attributed the increase to increases in the traditional business of trailer production due to the combination of a pricing increase in early 2005 and increased volume and third party scanning and recording, supplemented by revenue from two new business lines, digital intermediate and YCM revenue. Modest increases in visual effects and scanning and recording were offset by continued declines in analog and photochemical businesses.

*Cost of Sales.* Cost of sales increased \$2.6 million or 13.9% to \$21.3 million in 2005 as compared to \$18.7 million in 2004. Pacific Title attributes this increase to increases in labor and film costs, mainly related to increased sales and increases in depreciation and maintenance expenses related to increased capital expenditures and warranties of newer equipment expiring. Gross margin increased to 32% in 2005 as compared to 27% in 2004, due to utilization of under-utilized capacity, offset by lower margins on its newer offerings until scale is achieved.

*Selling, General and Administrative.* Selling, general and administrative expenses increased \$0.7 million or 12.7% to \$6.4 million in 2005 as compared to \$5.7 million in 2004. Pacific Title attributes the increase to increases in sales staffing and wages, commissions and management performance bonuses due to improved company performance.

*Net Income before Income Taxes.* Net income increased \$2.6 million in 2005. The increase was primarily due to increased revenues and improved gross profit margin.

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### Other Companies

	Year Ended December 31,		
	2006	2005 (In thousands)	2004
Revenue	\$ —	\$ —	\$ 1,278
Total operating expenses	—	—	2,674
Operating loss	—	—	(1,396)
Other income, net	812	5,826	40,939
Interest, net	—	—	(10)
Minority interest	—	—	584
Equity loss	(3,267)	(6,617)	(13,960)
Net income (loss) before income taxes	<u>\$ (2,455)</u>	<u>\$ (791)</u>	<u>\$ 26,157</u>

Revenue for the Other Companies segment in 2004 was primarily derived from Tangram, through its sale in February 2004.

#### *Other Income, Net*

	Year Ended December 31,		
	2006	2005 (In thousands)	2004
Gain on sale of companies and funds, net	\$ 1,181	\$ 7,292	\$ 44,486
Gain (loss) on trading securities	330	(229)	(396)
Impairment charges	—	(1,425)	(3,197)
Other	(699)	188	46
	<u>\$ 812</u>	<u>\$ 5,826</u>	<u>\$ 40,939</u>

Gain on sale of companies and funds for the year ended December 31, 2006 of \$1.2 million primarily related to the sale of a cost method investment whose carrying value was zero.

Gain on sale of companies and funds for the year ended December 31, 2005 of \$7.3 million, was primarily attributable to gains on the sales of certain interests in private equity funds. Total proceeds from the sale of these interests in private equity funds during 2005 were \$27.6 million. As a result of the sale, we were also relieved of \$9.1 million of future fund commitments.

Gain on sale of companies and funds for the year ended December 31, 2004 of \$44.5 million included a gain of \$31.7 million related to the sale of our interest in Sanchez and a gain of \$8.5 million related to our sale of Tangram. Also included was \$2.7 million attributable to a distribution from a bankruptcy proceeding and \$1.5 million relating to the final payment of an installment sale of a company sold in 1997. Total net cash proceeds for sales of companies and funds were \$37.5 million in 2004.

Gain on trading securities in 2006 primarily reflected a net gain of \$0.4 million on the sale of our holdings in Traffic.com.

Loss on trading securities in 2005 reflected the loss on the sale of holdings in stock distributed from a private equity fund, which were sold during the second quarter of 2005. Loss on trading securities in 2004 primarily reflected the adjustment to fair value of our holdings in Opsware and the subsequent loss on sale of Opsware stock of \$0.1 million.

We have recorded impairment charges for certain holdings accounted for under the cost method determined to have experienced an other-than-temporary decline in value in accordance with our existing policy regarding impairment of ownership interests in and advances to companies.

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

	Year Ended December 31,		
	2006	2005	2004
		(In thousands)	
Share of our equity method companies' results of operations	\$ (2,854)	\$ (2,319)	\$ (3,484)
Share of private equity funds' results of operations	(413)	(4,298)	(6,759)
Impairment charges	—	—	(3,717)
	<u>\$ (3,267)</u>	<u>\$ (6,617)</u>	<u>\$ (13,960)</u>

During 2006, we acquired interests in four companies accounted for under the equity method: Advantage Healthcare Solutions, NuPathe, Portico Systems and Rubicor Medical. Included in equity loss in 2006 were in-process research and development charges of \$1.0 million and \$0.6 million related to the allocations of purchase price of NuPathe and Rubicor Medical, respectively. New holdings in growth-stage companies are expected to lead to larger equity losses until those companies reach scale and achieve profitability.

During 2005, we restructured our ownership holdings in four private equity funds from a general partner to a special limited partner interest and we began accounting for these funds on the cost method. In December 2005, we sold most of our holdings in certain private equity funds. The decrease in equity loss related to private equity funds in 2006 compared to 2005 was a result of the sale of these holdings. These equity funds accounted for \$3.4 million and \$5.3 million of equity loss in 2005 and 2004, respectively.

## Corporate Operations

	Year Ended December 31,		
	2006	2005	2004
		(In thousands)	
General and administrative costs, net	\$ (20,112)	\$ (16,616)	\$ (16,783)
Stock-based compensation	(4,037)	(1,265)	(2,273)
Depreciation	(197)	(182)	(203)
Interest income	6,703	4,871	2,409
Interest expense	(4,617)	(4,914)	(8,864)
Recovery (impairment) — related party	360	28	(3,400)
Other income (loss), net	4,629	1,267	(2,826)
	<u>\$ (17,271)</u>	<u>\$ (16,811)</u>	<u>\$ (31,940)</u>

*General and Administrative Costs, Net.* Our general and administrative expenses consist primarily of employee compensation, insurance, outside services such as legal, accounting and consulting, and travel-related costs. General and administrative costs increased \$3.5 million in 2006 as compared to 2005. The increase was primarily related to a \$1.5 severance charge in 2006 and a \$1.4 increase in employee costs due to new hires to support Safeguard's long-term strategy, partially offset by a \$0.8 decrease in insurance expense. General and administrative costs decreased \$0.2 million in 2005 as compared to 2004. The net decrease was primarily attributable to a decline in insurance expense.

*Stock-Based Compensation.* Stock-based compensation consists primarily of expense related to stock option grants and grants of restricted stock and deferred stock units to our employees. The increase of \$2.8 million for 2006 as compared to 2005 was primarily attributable to the adoption of SFAS No. 123(R) on January 1, 2006. Prior to the adoption of SFAS 123(R) the Company recognized expense related to restricted stock and deferred stock units but not stock options. Stock-based compensation expense for 2006 included \$1.9 million related to market-based awards and \$2.1 million related to service-based awards, respectively. Stock based compensation expense related to corporate operations is included in Selling, general and administrative in the Consolidated Statements of Operations.

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*Interest Income.* Interest income includes all interest earned on cash and marketable security balances. Interest income increased \$1.8 million in 2006 as compared to 2005 due to higher interest rates partially offset by lower invested cash balances in 2006 as compared to 2005. Interest income increased \$2.5 million in 2005 as compared to 2004 due to increased interest rates earned on invested cash balances.

*Interest Expense.* Interest expense is primarily related to our 2.625% convertible senior debentures with a stated maturity of 2024. Interest expense decreased \$0.3 million in 2006 as compared to 2005. The decline was attributable to the repurchase of \$21 million of face value of the 2024 Debentures in 2006. Interest expense decreased \$4.0 million in 2005 as compared to 2004. The decline was attributable to the retirement of the 2006 Notes in 2004, including expenses in 2004 of \$1.4 million due to the accelerated amortization of deferred issuance costs.

*Recovery (Impairment) — related party.* In May 2001, we entered into a loan agreement with Mr. Musser, our former CEO. In December 2006, we restructured the obligation so that we could obtain new collateral. We received cash of \$1.0 million from the sale of collateral, which exceeded our then carrying value of the loan. The excess of \$0.4 million is reflected as Recovery-related party in the Consolidated Statements of Operations. Future cash receipts in excess of the carrying value of the note will be recognized as Recovery-related party. The carrying value of the loan at December 31, 2006 was zero.

*Other.* Included in 2006 was a net gain of \$4.3 million on the repurchase of \$21 million of face value of the 2024 Debentures. Included in this category for 2005 was a \$1.0 million gain related to the sale of a legacy asset. Included in this category in 2004 were costs associated with the repurchase of our 2006 Notes, including \$1.8 million due to the accelerated amortization of deferred issuance costs and \$1.4 million related to commissions and premiums paid.

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

Our consolidated net income tax benefit for 2006, was \$1.0 million. We recognized tax expense of \$0.3 million related to our share of net state tax expenses recorded by subsidiaries. We recognized a \$1.3 million tax benefit related to uncertain tax positions for which the statute of limitations expired during the period in the applicable tax jurisdictions. 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 net operating loss benefit that would have been recognized in 2006 was offset by a valuation allowance.

### ***Discontinued Operations***

In October 2006, we completed the sale of our interest in Mantas for net proceeds of \$112.8 million, including \$19.3 million held in escrow, to i-flex<sup>®</sup> solutions, ltd., an affiliate of Oracle Corporation. As a result of the sale, we recorded a gain of \$83.9 million in the fourth quarter of 2006. The results of Mantas are reported in discontinued operations for all periods through the date of its sale. Mantas sold its telecommunications business and certain related assets and liabilities in the first quarter of 2006 for \$2.1 million in cash. As a result of the sale, Mantas recorded a gain of \$1.9 million in the first quarter of 2006 which is also reported in discontinued operations.

Alliance Consulting completed the sale of its Southwest region in May 2006 for proceeds of \$4.5 million, including cash of \$3.0 million and stock of the acquiror of \$1.5 million which was subsequently sold. As a result of the sale, Alliance Consulting recorded a gain of \$1.6 million in the second quarter of 2006. Alliance Consulting's Southwest region is reported in discontinued operations for all periods presented through the date of its sale.

In December 2005, Laureate Pharma sold its Totowa, New Jersey facility for \$16.0 million in cash and recorded a gain of \$7.7 million on the transaction. The operating results of the Totowa facility are reported in discontinued operations in 2005.

In October 2004, we sold our interest in CompuCom for \$128 million in gross cash proceeds and recorded a gain of \$1.8 million on the sale. The results of CompuCom are reported in discontinued operations in 2004 through the date of its sale.

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The income from discontinued operations in 2006 of \$89.8 million was primarily attributable to the gain on the sale of Mantas and the gain on sale of Alliance Consulting's Southwest region.

The income from discontinued operations in 2005 of \$6.0 million was primarily attributable to the gain on the sale of the Totowa, New Jersey facility by Laureate Pharma partially offset by losses from Totowa and the Mantas telecommunications business. The loss from discontinued operations in 2004 of \$29.5 million was primarily attributable to impairment charges in 2004 related to the sale of CompuCom of \$19.8 million, net of a \$1.8 million gain on sale, \$11.9 million loss from Mantas, partially offset by \$2.2 million of income from Alliance Consulting's Southwest region.

### Liquidity And Capital Resources

#### *Parent Company*

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

In February 2004, we completed the sale of \$150 million of 2.625% convertible senior debentures with a stated maturity of March 15, 2024 (the "2024 Debentures"). We used all of the net proceeds of this offering of approximately \$146 million to retire a majority of the 2006 Notes through one or more privately negotiated transactions. The remainder of the 2006 Notes were retired subsequently in 2004.

As of December 31, 2006, at the parent company level, we had \$60.0 million of cash and cash equivalents and \$94.1 million of marketable securities for a total of \$154.1 million. In addition to the amounts above, we had \$9.6 million in escrow associated with our interest payments due on the 2024 Debentures through March 2009, \$19.4 million of restricted cash held in escrow, including accrued interest, associated with our sale of Mantas and our consolidated subsidiaries had cash and cash equivalents of \$11.0 million.

On a consolidated basis, proceeds from sale of discontinued operations were \$99.6 million in 2006, \$14.7 million in 2005 and \$125.9 million in 2004. Proceeds from sales of and distributions from partner companies and private equity funds were \$1.5 million in 2006, \$28 million in 2005 and \$39 million in 2004. Proceeds from sales of available-for-sale and trading securities were \$3.6 million in 2006, \$0.2 million in 2005 and \$15 million in 2004.

In May 2006, we renewed our revolving credit facility that provides for borrowings and issuances of letters of credit and guarantees of up to \$55 million. Borrowing availability under the facility is reduced by the amounts outstanding for our borrowings and letters of credit and amounts guaranteed under partner company facilities maintained with that same lender. This credit facility matures in May 2007 and bears interest at the prime rate (8.25% at December 31, 2006) for outstanding borrowings. The credit facility is subject to an unused commitment fee of 0.125%, which is subject to reduction based on deposits maintained at the bank. The facility requires cash collateral equal to one times our borrowings and letters of credit and amounts borrowed by partner companies under the guaranteed portion of the partner company facilities maintained at the same bank. As of December 31, 2006, three subsidiaries were not in compliance with certain financial covenants under their respective facilities and subsequently received waivers from the lender.

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

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Availability under our revolving credit facilities at December 31, 2006 was as follows (in thousands):

	Total
Size of facilities	\$ 75,000
Subsidiary facilities at same banks (a)	(28,000)
Outstanding letter of credit (b)	(6,336)
Amount available at December 31, 2006	<u>\$ 40,664</u>

- (a) Our ability to borrow under the credit facilities is limited by the amounts outstanding for our borrowings and letters of credit and amounts guaranteed under partner company facilities maintained at the same respective banks. Of the total facilities, \$25.5 million was outstanding under these facilities at December 31, 2006 and was included as debt on the Consolidated Balance Sheet.
- (b) In connection with the sale of CompuCom, we provided to the landlord of CompuCom's Dallas headquarters, a letter of credit, which will expire on March 19, 2019, in an amount equal to \$6.3 million.

On February 28, 2007, all subsidiary facilities were extended for one year, with the exception of Acsis' facility, which expires in August 2008 and Pacific Title's facility which was not renewed by Pacific Title and under which there were no borrowings. In addition to the extension of the maturity dates, a subsidiary's working capital line was increased by \$5.5 million and that same subsidiary entered into a \$6 million equipment facility, all of which we guaranteed. Our \$10 million guarantee on a subsidiary facility was decreased to \$5 million and related interest rates on outstanding borrowings were also changed. In January 2007, Clariant increased its facility by \$3.5 million, all of which we guaranteed. As a result of these amendments, our availability under the facilities has decreased by \$10.3 million. Availability under the facilities at March 22, 2007 was \$30.4 million.

We have committed capital of approximately \$6.2 million comprising commitments made to various private equity funds in prior years and a conditional commitment to provide a partner company with additional funding, to be funded over the next several years, including approximately \$4.9 million which is expected to be funded in the next twelve months. We do not intend to commit to new investments in additional private equity funds and may seek to further reduce our current ownership interests in, and our existing commitments to the funds in which we hold interests.

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

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

We have received distributions as both a general partner and a limited partner from certain private equity funds. Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner to the fund for further distribution to the fund's limited partners (the "clawback"). Assuming for these

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purposes only that the funds were liquidated or dissolved on December 31, 2006 and the only distributions from the funds were equal to the carrying value of the funds on the December 31, 2006 financial statements, the maximum clawback we would be required to return for our general partner interest is \$8 million. As of December 31, 2006 management estimated this liability to be approximately \$6.7 million, of which \$5.3 million was reflected in accrued expenses and other current liabilities and \$1.4 million was reflected in other long-term liabilities on the Consolidated Balance Sheets.

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

We have outstanding \$129 million of 2.625% convertible senior debentures with a stated maturity of March 15, 2024. Interest on these 2024 Debentures is payable semi-annually. At the note holders' option, the notes are convertible into our common stock before the close of business on March 14, 2024 subject to certain conditions. The conversion rate of the notes at December 31, 2006 was \$7.2174 of principal amount per share. The closing price of our common stock on December 31, 2006 was \$2.42. The note holders may require repurchase of the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective amount plus accrued and unpaid interest. The note holders may also require repurchase of the 2024 Debentures upon certain events, including sale of all or substantially all of our common stock or assets, liquidation, dissolution or a change in control. Subject to certain conditions, we may redeem all or some of the 2024 Debentures commencing March 20, 2009. During 2006, we repurchased \$21 million of face value of the 2024 Debentures for \$16.4 million in cash, including accrued interest.

For the reasons we presented above, we believe our cash and cash equivalents at December 31, 2006, availability under our revolving credit facilities and other internal sources of cash flow will be sufficient to fund our cash requirements for at least the next twelve months, including commitments to our existing companies and funds, our current operating plan to acquire interests in new partner companies, potential monetization activities, possible additional funding of existing partner companies and our general corporate requirements.

### *Consolidated Subsidiaries*

Most of our consolidated subsidiaries incurred losses in 2006 and may need additional capital to fund their operations. From time-to-time, some or all of our consolidated subsidiaries may require additional debt or equity financing or credit support from us to fund planned expansion activities. If we decide not to provide sufficient capital resources to allow them to reach a positive cash flow position, and they are unable to raise capital from outside resources, they may need to scale back their operations. If Alliance Consulting and Pacific Title meet their business plans for 2007 and the related milestones established by us, we believe they will have sufficient cash or availability under established lines of credit to fund their operations for at least the next twelve months. We expect Acsis and Clariant will require additional capital in 2007 to fund their business plans, and we believe that Laureate Pharma may need additional capital in 2007. As described below, we have recently provided a revolving line of credit to Clariant, and we intend to support Acsis and Laureate Pharma capital requirements as needed.

Consolidated subsidiaries have outstanding credit facilities that provide for borrowings of up to \$57.5 million. These facilities contain financial and non-financial covenants and expire at various points in the first quarter of 2007, with the exception of Acsis' credit facility, which was renewed in August 2006 and expires in 2008. As of December 31, 2006, three subsidiaries were not in compliance with certain financial covenants under their respective facilities and subsequently received waivers from the lender.

As of December 31, 2006, outstanding borrowings under these facilities were \$25.5 million.

On March 7, 2007, we provided a subordinated revolving credit line (the "Mezzanine Facility") to Clariant. Under the Mezzanine Facility, which expires December 8, 2008, we committed to provide Clariant access to up to \$6 million in working capital funding. Amounts funded under the Mezzanine Facility will earn interest at an annual

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rate of 12%. The Mezzanine Facility was originally \$12 million, but was reduced by \$6 million as a result of the ACIS Sale.

In September 2006, Clariant entered into a \$5 million senior secured revolving credit agreement. Borrowing availability under the agreement is based on the level of Clariant's qualified accounts receivable, less certain reserves. The agreement has a two-year term and bears interest at variable rates based on the lower of LIBOR plus 3.25% or the prime rate plus 0.5%. As of December 31, 2006, Clariant borrowed \$2.5 million and had no availability under this facility based on the level of qualified accounts receivable. As of December 31, 2006, Clariant was not in compliance with a financial covenant under this agreement and subsequently received a waiver from the lender.

Clariant also entered into a Master Purchase Agreement pursuant to which it sold its ACIS cost-per-test units that were previously leased to customers for a gross amount of \$2.7 million in 2006.

### *Analysis of Parent Company Cash Flows*

Cash flow activity for the Parent Company was as follows:

	Year Ended December 31,		
	2006	2005	2004
		(In thousands)	
Net cash used in operating activities	\$(12,039)	\$(13,534)	\$(24,463)
Net cash (used in) provided by investing activities	(16,159)	(16,000)	86,070
Net cash provided by (used in) financing activities	(20,169)	9,572	(54,863)
	<u>\$(48,367)</u>	<u>\$(19,962)</u>	<u>\$ 6,744</u>

#### *Cash Used In Operating Activities*

*2006 vs. 2005.* Cash used in operating activities decreased \$1.5 million in 2006 as compared to 2005. The decrease was primarily due to a changes in working capital and an increase in interest income as a result of higher average interest rates, partially offset by an increase in operating costs.

*2005 vs. 2004.* Cash used in operating activities decreased \$10.9 million in 2005 as compared to 2004. The decrease was primarily due to a reduction in interest expense as a result of the retirement of the 2006 Notes, an increase in interest income and change in working capital .

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

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

*2006 vs. 2005.* Cash (used in) investing activities increased \$0.2 million in 2006 as compared to 2005. The increase was primarily due to an \$7.6 million increase in cash used to acquire ownership interests in companies and subsidiaries, a \$64.2 million increase in cash used to purchase short-term investments and a \$27.9 million decrease in proceeds from sales of and distributions from companies, partially offset by an increase in proceeds from sale of discontinued operations of \$93.4 million and a \$3.3 million increase in proceeds from sales of available-for-sale and trading securities.

*2005 vs. 2004.* Cash (used in) provided by investing activities declined \$102.1 million in 2005 as compared to 2004. The decline was primarily attributable to \$125.9 million received in 2004 from the sale of CompuCom, a \$14.5 million decline in proceeds from sales of available-for-sale and trading securities, as well as a \$9.6 million decline in proceeds from sales of and distributions from companies, partially offset by \$13.3 million less cash used to acquire ownership interest in companies and subsidiaries, net of cash acquired, and a net increase of \$27.8 million of cash provided by sale of restricted cash and short-term investments. In December 2005, we sold our holdings in eight private equity funds for \$24 million in cash proceeds. Included in 2004 was \$32.1 million in cash proceeds related to our sale of Sanchez and proceeds from sales of available-for-sale and trading securities of \$14.8 million. Partially offsetting these amounts in 2004 was a \$12.5 million investment in Clariant as compared to \$9.0 million in 2005.

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Also included in 2004 was \$5.0 million repayment of an advance to a related party. The 2004 period reflected a net increase of \$26.0 million in short-term investments, including commercial paper and certificates of deposit, as the company invested in longer maturity securities to take advantage of higher interest rates.

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

2006 vs. 2005. Cash provided by (used in) financing activities decreased \$29.7 million in 2006 as compared to 2005, primarily due to the repurchase of a portion of our convertible senior debentures for \$16.2 million, excluding accrued interest, and the repayment of intercompany advances from a subsidiary.

2005 vs. 2004. Cash provided by financing activities increased \$64.4 million in 2005 as compared to 2004. The activity in 2004 related to net proceeds of \$145.1 million from the issuance of our 2024 Debentures, offset by \$201.4 million which was used to redeem the 2006 Notes.

### *Consolidated Working Capital From Continuing Operations*

Consolidated working capital from continuing operations decreased to \$137 million at December 31, 2006 compared to \$146 million at December 31, 2005. The decrease is primarily attributable to cash used to fund new and follow-on holdings and to fund continuing operations, partially offset by proceeds from sale of discontinued operations.

### *Analysis of Consolidated Cash Flows*

Cash flow activity was as follows, including cash flows from Mantas' business for which cash was included in current assets from discontinued operations for all periods presented.

	Year Ended December 31,		
	2006	2005	2004
		(In thousands)	
Net cash (used in) provided by operating activities	\$(18,379)	\$(21,910)	\$ 19,123
Net cash (used in) provided by investing activities	(27,590)	1,411	87,432
Net cash provided by (used in) financing activities	(5,527)	2,360	(34,826)
	<u>\$(51,496)</u>	<u>\$(18,139)</u>	<u>\$ 71,729</u>

### *Cash (Used In) Provided by Operating Activities*

2006 vs. 2005. Net cash used in operating activities decreased \$3.5 million in 2006 as compared to 2005. The decrease was primarily due to favorable changes in working capital, offset partially by results of continuing operations of partner companies.

2005 vs. 2004. Net cash used in operating activities increased \$41.0 million in 2005 as compared to 2004. The increase was primarily attributable to working capital changes partially offset by improved results at partner companies.

### *Cash Provided by Investing Activities*

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

2006 vs. 2005. Net cash used in investing activities increased \$29.0 million in 2006 as compared to 2005. The increase was primarily attributable to a \$64.2 million increase in cash used to purchase short-term investments, a \$8.6 million increase in cash used to acquire ownership interests in companies and funds, a \$8.8 million increase in cash used for acquisitions by subsidiaries and a decrease of \$26.7 million in proceeds from sales of and distributions from companies, partially offset by a \$85.0 million increase in proceeds from sale of discontinued operations.

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2005 vs. 2004. Cash provided by investing activities decreased by \$86.0 million in 2005 as compared to 2004. A decrease of \$111.2 million was attributable to a decline in proceeds from discontinued operations. Included in 2005, were \$14.7 million net cash proceeds related to the sale of Laureate Pharma's Totowa, New Jersey facility. Included in 2004 were proceeds of \$125.9 million related to the sale of CompuCom. The decrease was also attributable to a \$14.5 million decline in proceeds from sales of available-for-sale and trading securities and \$10.9 million decline in proceeds from sales of and distributions from partner companies and private equity funds. Included in 2004 was \$32.1 million in cash proceeds related to our sale of Sanchez and proceeds from sales of available-for-sale and trading securities of \$14.8 million.

Also included in 2004 was a net increase of \$26.0 million in short-term investments, including commercial paper and certificates of deposit, as the company invested in longer maturity securities to take advantage of higher interest rates.

### Cash Provided by (Used In) Provided by Financing Activities

2006 vs. 2005. Net cash (used in) provided by financing activities decreased \$7.9 million in 2006 as compared to 2005, primarily due to the repurchase of a portion of our convertible senior debentures for \$16.2 million, excluding accrued interest, partially offset by increased borrowings on revolving credit facilities.

2005 vs. 2004. Net cash provided by financing activities increased \$37.2 million in 2005 as compared to 2004. Included in 2005 was \$6.2 million related to issuance of subsidiary common stock to third parties by Clariant, as compared to \$13.5 million in 2004. The activity in 2004 related to net proceeds of \$145.1 million from the issuance of our 2024 Debentures, offset by \$201.4 million which was used to redeem the 2006 Notes.

### Contractual Cash Obligations and Other Commercial Commitments

The following table summarizes our contractual obligations and other commercial commitments as of December 31, 2006, by period due or expiration of the commitment.

	Payments Due by Period				
	Total	2007	2008 and 2009 (In millions)	2010 and 2011	Due after 2011
<b>Contractual Cash Obligations:</b>					
Lines of credit (a)	\$ 25.0	\$ 25.0	\$ —	\$ —	\$ —
Long-term debt (a)	4.9	1.8	3.1	—	—
Capital leases	4.1	2.1	2.0	—	—
Convertible senior debentures (b)	129.0	—	—	—	129.0
Operating leases	24.8	5.9	9.0	3.6	6.3
Funding commitments (c)	6.2	4.9	1.2	0.1	—
Potential clawback liabilities (d)	6.7	5.3	—	—	1.4
Other long-term obligations (e)	3.6	0.8	1.6	1.2	—
<b>Total Contractual Cash Obligations</b>	<b>\$ 204.3</b>	<b>\$ 45.8</b>	<b>\$ 16.9</b>	<b>\$ 4.9</b>	<b>\$ 136.7</b>
<b>Amount of Commitment Expiration by Period</b>					
	Total	2007	2008 and 2009 (in millions)	2010 and 2011	Due after 2011
<b>Other Commitments:</b>					
Letters of credit (f)	\$ 9.4	\$ 3.1	\$ —	\$ —	\$ 6.3

(a) We have various forms of debt including lines of credit, term loans and equipment leases. Of our total outstanding guarantees of \$36.5 million, \$25.5 million of outstanding debt associated with the guarantees was included on the Consolidated Balance Sheets at December 31, 2006. See Note 17 to the Consolidated Financial Statements. The remaining \$11.0 million was not reflected on the Consolidated Balance Sheets or in the above table.

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- (b) In February 2004, we completed the issuance of \$150 million of the 2024 Debentures with a stated maturity of March 15, 2024. During 2006, we repurchased \$21 million of the face value of the 2024 Debentures for \$16.4 million in cash. The 2024 Debenture holders may require the Company to repurchase the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount plus accrued and unpaid interest.
- (c) These amounts include funding commitments to private equity funds and private companies. The amounts have been included in the respective years based on estimated timing of capital calls provided to us by the funds' management. Also included is our \$3.0 million conditional commitment to provide a partner company with additional funding.
- (d) We have received distributions as both a general partner and a limited partner from certain private equity funds. Under certain circumstances, we may be required to return a portion or all the distributions we received as a general partner to the fund for a further distribution to the fund's limited partners (the "clawback"). Assuming the funds were liquidated or dissolved on December 31, 2006 and the only value provided by the funds was the carrying values represented on the December 31, 2006 financial statements, the maximum clawback we would be required to return is \$8 million. As of December 31, 2006, management estimated its liability to be approximately \$6.7 million, of which \$5.3 million was reflected in accrued expenses and other current liabilities and \$1.4 million was reflected in other long-term liabilities on the Consolidated Balance Sheets.
- (e) Reflects the amount payable to our former Chairman and CEO under a consulting contract.
- (f) Letters of credit include a \$6.3 million letter of credit provided to the landlord of CompuCom's Dallas headquarters lease in connection with the sale of CompuCom and \$3.1 million of letters of credit issued by subsidiaries supporting their office leases.

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, 2006.

As of December 31, 2006, Safeguard and its subsidiaries consolidated for tax purposes had federal net operating loss carryforwards and federal capital loss carryforwards of approximately \$254 million and \$140 million, respectively. The net operating loss carryforwards expire in various amounts from 2007 to 2024. The capital loss carryforwards expire in various amounts from 2007 to 2008. Limitations on utilization of both the net operating loss carryforwards and capital loss carryforwards may apply.

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***

In September 2006, the United States Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 requires companies to evaluate the materiality of identified unadjusted errors using both the income statement approach and the balance sheet approach. In the initial year of adoption, if a company determines that an adjustment to prior year financial statements is required under either approach, SAB 108 allows for a one-time cumulative-effect adjustment to beginning retained earnings. SAB 108 is effective for interim periods of the first fiscal year ending after November 15, 2006. The adoption of SAB No. 108 did not have an impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial

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statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of SFAS No. 157 to have a material impact on our financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained upon examination by the applicable taxing authority. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. We do not believe adoption of FIN 48 will have a material effect on our consolidated financial position, results of operations or cash flows and will consist of reclassification of certain income tax-related liabilities.

In November 2005, the FASB issued FASB Staff Position SFAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-based Payment Awards", that provides an elective alternative transition method of calculating the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R) (the "APIC Pool") to the method otherwise required by paragraph 81 of SFAS No. 123(R). In the fourth quarter of 2006, we adopted the short-cut method to calculate the APIC Pool.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"). SFAS No. 123(R) requires companies to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. In addition, the adoption of SFAS No. 123(R) requires additional accounting and disclosure related to the income tax and cash flow effects resulting from share-based payment arrangements. We adopted SFAS No. 123(R) on January 1, 2006 using the modified prospective method. See Note 12 to the Consolidated Financial Statements.

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to equity price risks on the marketable portion of our securities. These securities include equity positions in partner companies, many of which have experienced significant volatility in their stock prices. Historically, we have not attempted to reduce or eliminate our market exposure on securities. Based on closing market prices at December 31, 2006, the fair market value of our holdings in public securities was approximately \$73.3 million. A 20% decrease in equity prices would result in an approximate \$14.7 million decrease in the fair value of our publicly traded securities.

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

Liabilities	2007	2008	2009	After 2009	Fair Market Value at 12/31/06
Convertible Senior Debentures due by year (in millions)	\$ —	\$ —	\$ —	\$ 129.0	\$ 104.5
Fixed Interest Rate	2.625%	2.625%	2.625%	2.625%	
Interest Expense (in millions)	<u>\$ 3.4</u>	<u>\$ 3.4</u>	<u>\$ 3.4</u>	<u>\$ 54.9</u>	

At December 31, 2006, our outstanding debt totaled \$34.0 million, which consisted of fixed rate debt of \$6.0 million and variable-rate debt of \$28.0 million. Based on our 2006 average outstanding borrowings under our variable-rate debt, a one-percentage point increase in interest rates would negatively impact our annual pre-tax earnings and cash flows by approximately \$0.5 million.

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.

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

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

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## **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our 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 evaluated our internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control-Integrated Framework* (COSO). As a result of this assessment and based on the criteria in the COSO framework, management has concluded that, as of December 31, 2006, our internal control over financial reporting was effective.

Our independent registered public accounting firm, KPMG LLP, has audited management's assessment of our internal control over financial reporting. Their opinion on management's assessment and the effectiveness of our internal control over financial reporting and their opinion on our financial statements appear on the following pages.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders  
Safeguard Scientifics, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting appearing on page 63 of the financial statements, that Safeguard Scientifics, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management of Safeguard Scientifics, Inc. is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and 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, management's assessment that Safeguard Scientifics, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by COSO. Also, in our opinion, Safeguard Scientifics, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

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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. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive loss, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated March 27, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Philadelphia, Pennsylvania  
March 27, 2007

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders  
Safeguard Scientifics, Inc.:

We have audited the accompanying consolidated balance sheets of Safeguard Scientifics, Inc. (the “Company”) and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive income (loss), shareholders’ equity and cash flows for each of the years in the three-year period ended December 31, 2006. 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. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1, to the consolidated financial statements, the Company adopted SFAS No. 123R, Share-Based Payment, on January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of internal control over financial reporting of Safeguard Scientifics, Inc. as of December 31, 2006, 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 27, 2007 expressed an unqualified opinion on management’s assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Philadelphia, Pennsylvania  
March 27, 2007

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

	As of December 31,	
	2006	2005
	(In thousands except per share data)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 71,251	\$ 124,916
Restricted cash — current	—	1,098
Marketable securities	94,155	31,770
Restricted marketable securities	3,869	3,805
Accounts receivable, less allowances (\$1,793 — 2006; \$1,720 — 2005)	38,560	41,006
Prepaid expenses and other current assets	7,151	5,498
Current assets of discontinued operations	—	12,263
Total current assets	214,986	220,356
Property and equipment, net	44,889	37,739
Ownership interests in and advances to companies	54,548	17,897
Long-term marketable securities	487	3,311
Long-term restricted marketable securities	5,737	9,457
Intangible assets, net	16,426	15,312
Goodwill	82,498	77,972
Cash held in escrow	19,630	—
Other	4,180	5,563
Non-current assets of discontinued operations	—	28,695
Total Assets	<u>\$ 443,381</u>	<u>\$ 416,302</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Current portion of credit line borrowings	\$ 25,014	\$ 13,023
Current maturities of long-term debt	3,938	3,374
Current portion of convertible senior debentures	—	5,000
Accounts payable	11,111	10,358
Accrued compensation and benefits	14,614	12,310
Accrued expenses and other current liabilities	19,165	14,567
Deferred revenue	4,250	3,465
Current liabilities of discontinued operations	—	12,718
Total current liabilities	78,092	74,815
Long-term debt	5,067	5,170
Other long-term liabilities	10,918	14,013
Convertible senior debentures	129,000	145,000
Deferred taxes	911	895
Minority interest	5,491	10,478
Non-current liabilities of discontinued operations	—	956
Commitments and contingencies Redeemable subsidiary stock-based compensation	2,021	—
Shareholders' Equity:		
Preferred stock, \$0.10 par value; 1,000 shares authorized	—	—
Common stock, \$0.10 par value; 500,000 shares authorized; 120,419 and 119,935 shares issued and outstanding in 2006 and 2005, respectively	12,042	11,993
Additional paid-in capital	750,361	747,953
Accumulated deficit	(551,058)	(597,088)
Accumulated other comprehensive income	536	3,166
Treasury stock, at cost (2 shares-2005)	—	(6)
Unamortized deferred compensation	—	(1,043)
Total shareholders' equity	211,881	164,975
Total Liabilities and Shareholders' Equity	<u>\$ 443,381</u>	<u>\$ 416,302</u>

See Notes to Consolidated Financial Statements.

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

	Year Ended December 31,		
	2006	2005	2004
(In thousands except per share data)			
<b>Revenue:</b>			
Product sales	\$ 10,668	\$ 5,898	\$ 2,211
Service sales	<u>187,392</u>	<u>137,933</u>	<u>107,143</u>
Total revenue	<u>198,060</u>	<u>143,831</u>	<u>109,354</u>
<b>Operating Expenses:</b>			
Cost of sales — product	7,556	1,921	2,532
Cost of sales — service	134,834	103,260	74,882
Selling, general and administrative	99,962	74,178	73,053
Research and development	6,977	3,794	4,699
Purchased in-process research and development	—	2,183	89
Amortization of intangibles	<u>3,413</u>	<u>2,367</u>	<u>2,192</u>
Total operating expenses	<u>252,742</u>	<u>187,703</u>	<u>157,447</u>
Operating loss	(54,682)	(43,872)	(48,093)
Other income, net	5,573	7,338	38,803
Recovery (impairment) — related party	360	28	(3,400)
Interest income	6,914	4,984	2,612
Interest expense	(6,821)	(6,428)	(9,585)
Equity loss	(3,267)	(6,597)	(14,534)
Minority interest	<u>7,120</u>	<u>6,356</u>	<u>8,736</u>
Net loss from continuing operations before income taxes	(44,803)	(38,191)	(25,461)
Income tax benefit	<u>1,023</u>	<u>83</u>	<u>120</u>
Net loss from continuing operations	(43,780)	(38,108)	(25,341)
Income (loss) from discontinued operations, net of tax	<u>89,810</u>	<u>6,038</u>	<u>(29,479)</u>
Net income (loss)	<u>\$ 46,030</u>	<u>\$ (32,070)</u>	<u>\$ (54,820)</u>
<b>Basic Income (Loss) Per Share:</b>			
Net loss from continuing operations	\$ (0.36)	\$ (0.32)	\$ (0.21)
Net income (loss) from discontinued operations	<u>0.74</u>	<u>0.05</u>	<u>(0.25)</u>
Net income (loss) per share	<u>\$ 0.38</u>	<u>\$ (0.27)</u>	<u>\$ (0.46)</u>
<b>Diluted Income (Loss) Per Share:</b>			
Net loss from continuing operations	\$ (0.36)	\$ (0.32)	\$ (0.21)
Net income (loss) from discontinued operations	<u>0.74</u>	<u>0.05</u>	<u>(0.25)</u>
Net income (loss) per share	<u>\$ 0.38</u>	<u>\$ (0.27)</u>	<u>\$ (0.46)</u>
Shares used in computing basic and diluted income (loss) per share	<u>121,476</u>	<u>120,845</u>	<u>119,965</u>

See Notes to Consolidated Financial Statements.

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

	Year Ended December 31,		
	<u>2006</u>	<u>2005</u> (in thousands)	<u>2004</u>
Net loss from continuing operations	\$(43,780)	\$(38,108)	\$(25,341)
Other comprehensive income (loss), before taxes:			
Foreign currency translation adjustments	5	69	(45)
Unrealized holding gains (losses) in available-for-sale securities	(2,824)	(8,653)	11,964
Other comprehensive income (loss) from continuing operations	(2,819)	(8,584)	11,919
Comprehensive loss from continuing operations	(46,599)	(46,692)	(13,422)
Income (loss) from discontinued operations	89,810	6,038	(29,479)
Other comprehensive income (loss) from discontinued operations	189	(36)	(94)
Comprehensive income (loss)	<u>\$ 43,400</u>	<u>\$(40,690)</u>	<u>\$(42,995)</u>

See Notes to Consolidated Financial Statements.

**SAFEGUARD SCIENTIFICS, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)  (In thousands)	Treasury Stock		Unamortized Deferred Compensation	Total
	Shares	Amount				Shares	Amount		
<b>Balance —</b>									
<b>December 31, 2003</b>	119,450	\$11,945	\$737,560	\$ (510,198)	\$ (39)	53	\$ (191)	\$ (2,906)	\$236,171
Net loss	—	—	—	(54,820)	—	—	—	—	(54,820)
Stock options exercised, net	369	37	1,104	—	—	(73)	251	—	1,392
Acceleration of vesting of stock options	—	—	130	—	—	—	—	—	130
Amortization of deferred compensation	—	—	—	—	—	—	—	2,729	2,729
Impact of subsidiary equity transactions	—	—	4,088	—	—	—	—	(389)	3,699
Issuance of restricted stock, net	74	7	3,109	—	—	20	(60)	(2,952)	104
Other comprehensive income	—	—	—	—	11,825	—	—	—	11,825
<b>Balance —</b>									
<b>December 31, 2004</b>	119,893	11,989	745,991	(565,018)	11,786	—	—	(3,518)	201,230
Net loss	—	—	—	(32,070)	—	—	—	—	(32,070)
Stock options exercised, net	42	4	48	—	—	(2)	9	—	61
Acceleration of vesting of restricted stock	—	—	—	—	—	—	—	279	279
Amortization of deferred compensation, net of forfeitures	—	—	(203)	—	—	—	—	1,371	1,168
Impact of subsidiary equity transactions	—	—	1,859	—	—	—	—	838	2,697
Issuance of restricted stock, net	—	—	113	—	—	4	(15)	(13)	85
Employee stock option expense	—	—	145	—	—	—	—	—	145
Other comprehensive loss	—	—	—	—	(8,620)	—	—	—	(8,620)
<b>Balance —</b>									
<b>December 31, 2005</b>	119,935	11,993	747,953	(597,088)	3,166	2	(6)	(1,043)	164,975
Net income	—	—	—	46,030	—	—	—	—	46,030
Stock options exercised, net	236	25	346	—	—	(2)	6	—	377
Reclassification of unamortized deferred compensation	—	—	(1,043)	—	—	—	—	1,043	—
Reclassification of redeemable subsidiary stock-based compensation	—	—	(2,021)	—	—	—	—	—	(2,021)
Impact of subsidiary equity transactions	—	—	(1,763)	—	—	—	—	—	(1,763)
Issuance of restricted stock, net	248	24	47	—	—	—	—	—	71
Stock-based compensation expense	—	—	6,842	—	—	—	—	—	6,842
Other comprehensive loss	—	—	—	—	(2,630)	—	—	—	(2,630)
<b>Balance —</b>									
<b>December 31, 2006</b>	<u>120,419</u>	<u>\$12,042</u>	<u>\$750,361</u>	<u>\$ (551,058)</u>	<u>\$ 536</u>	<u>—</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$211,881</u>

See Notes to Consolidated Financial Statements.



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

	Year Ended December 31,		
	2006	2005 (In thousands)	2004
<b>Cash Flows from Operating Activities:</b>			
Net income (loss)	\$ 46,030	\$ (32,070)	\$ (54,820)
Adjustments to reconcile to net cash provided by (used in) operating activities:			
(Income) loss from discontinued operations	(89,810)	(6,038)	29,479
Depreciation and amortization	14,562	11,496	9,440
Purchased in-process research and development	—	2,183	—
Deferred income taxes	16	(51)	62
Equity loss	3,267	6,597	14,534
Other income, net	(5,573)	(7,338)	(38,803)
Impairment	—	—	—
(Recovery) impairment — related party	(360)	(28)	3,400
Non-cash compensation charges	6,842	2,613	4,210
Minority interest	(7,120)	(6,356)	(8,438)
Changes in assets and liabilities, net of effect of acquisitions and dispositions:			
Accounts receivable, net	2,231	(1,771)	(2,769)
Accounts payable, accrued expenses, deferred revenue and other	9,361	7,349	(4,356)
Cash flows from operating activities of discontinued operations	2,175	1,504	67,184
Net cash (used in) provided by operating activities	<u>(18,379)</u>	<u>(21,910)</u>	<u>19,123</u>
<b>Cash Flows from Investing Activities:</b>			
Proceeds from sales of available-for-sale and trading securities	3,551	241	14,784
Proceeds from sales of and distributions from companies and funds	1,530	28,242	39,085
Advances to companies	—	(2,299)	(1,015)
Repayment of advances to companies	—	—	400
Acquisitions of ownership interests in companies and funds, net of cash acquired	(43,596)	(35,034)	(34,797)
Acquisitions by subsidiaries, net of cash acquired	(8,778)	—	(57)
Repayment of note receivable-related party, net	360	1,413	7,162
Increase in restricted cash and marketable securities	(208,514)	(55,602)	(37,660)
Decrease in restricted cash and marketable securities	146,129	57,387	11,643
Purchase of restricted securities	—	—	(16,715)
Proceeds from sales of property and equipment	445	4,212	—
Capital expenditures	(17,949)	(11,966)	(9,597)
Capitalized software costs	(171)	(171)	(4,300)
Proceeds from sale of discontinued operations, net	99,649	14,680	125,853
Other, net	(153)	663	4,182
Cash flows from investing activities of discontinued operations	(93)	(355)	(11,536)
Net cash (used in) provided by investing activities	<u>(27,590)</u>	<u>1,411</u>	<u>87,432</u>
<b>Cash Flows from Financing Activities:</b>			
Proceeds from convertible senior debentures	—	—	150,000
Payments of offering costs on convertible senior debentures	—	—	(4,887)
Repurchase of convertible senior debentures	(16,215)	—	—
Repurchase of convertible subordinated notes	—	—	(200,000)
Payments of costs to repurchase convertible subordinated notes	—	—	(1,368)
Borrowings on revolving credit facilities	137,221	101,936	67,931
Repayments on revolving credit facilities	(125,206)	(100,521)	(62,496)
Borrowings on term debt	5,112	2,072	2,796
Repayments on term debt	(4,648)	(6,944)	(2,291)
Decrease (increase) in restricted cash	(232)	508	44
Issuance of Company common stock, net	448	61	1,392
Issuance of subsidiary common stock, net	432	6,196	4,176
Purchase of subsidiary common stock, net	(1,112)	(611)	—
Offering costs on issuance of subsidiary common stock	(70)	(343)	(1,580)
Cash flows from financing activities of discontinued operations	(1,257)	6	11,457
Net cash provided by (used in) financing activities	<u>(5,527)</u>	<u>2,360</u>	<u>(34,826)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(51,496)	(18,139)	71,729
Changes in Cash and Cash Equivalents from Mantas and CompuCom included in assets of discontinued operations	<u>(2,169)</u>	<u>(343)</u>	<u>(58,007)</u>

	(53,665)	(18,482)	13,722
Cash and Cash Equivalents at beginning of period	<u>\$ 124,916</u>	<u>\$ 143,398</u>	<u>\$ 129,676</u>
Total Cash and Cash Equivalents	<u><u>\$ 71,251</u></u>	<u><u>\$ 124,916</u></u>	<u><u>\$ 143,398</u></u>

See Notes to Consolidated Financial Statements.

**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 growth-stage technology and life sciences businesses. The Company provides growth capital as well as a range of strategic, operational and management resources to our partner companies. The Company participates in expansion financings, carve-outs, management buy-outs, recapitalizations, industry consolidations and early-stage financings. The Company’s vision is to be the preferred catalyst for creating great technology and life sciences companies.

The Company strives to create long-term value for its shareholders through building value in its partner companies. Safeguard helps its partner companies in their efforts to increase market penetration, grow revenue and improve cash flow in order to create long-term value. The Company concentrates on companies that operate in two categories:

- *Technology* — including companies focused on providing software as a service (SaaS), technology-enabled services and information technology services for analytics, enterprise applications and infrastructure, security and communication; and
- *Life Sciences* — including companies focused on specialty pharmaceuticals, drug delivery, diagnostics and medical devices.

***Basis of Presentation***

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

The Company’s Consolidated Statements of Operations, Comprehensive Income (Loss) and Cash Flows from continuing operations include the following subsidiaries:

<u>December 31, 2006</u>	<u>Year Ended December 31, 2005</u>	<u>December 31, 2004</u>
Acsis, Inc. (“Acsis”)	Acsis (since December 2005)	Alliance Consulting
Alliance Consulting Group Associates, Inc. (“Alliance Consulting”)	Alliance Consulting	Clariant
Clariant, Inc. (“Clariant”)	Clariant	Laureate Pharma (since December 2004)
Laureate Pharma, Inc. (“Laureate Pharma”)	Laureate Pharma	Pacific Title
Pacific Title & Art Studio, Inc. (“Pacific Title”)	Pacific Title	Tangram (through February 2004)

The Company’s Consolidated Balance Sheets include the following majority-owned subsidiaries:

<u>December 31, 2006 and 2005</u>
Acsis
Alliance Consulting
Clariant
Laureate Pharma
Pacific Title

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Alliance Consulting operates on a 52- or 53-week fiscal year, ending on the Saturday closest to December 31. Alliance Consulting's last three fiscal years have ended on December 30, 2006, December 31, 2005 and January 1, 2005. Fiscal years 2006 and 2005 were periods of 52 weeks, and 2004 was a period of 53 weeks. The Company and all other subsidiaries operate on a calendar year.

During 2006, 2005 and 2004, certain consolidated companies, or components thereof, were sold. See Note 2 for discontinued operations treatment of Mantas, Alliance Consulting's Southwest region, Laureate Pharma's Totowa facility and CompuCom.

Tangram was consolidated through February 20, 2004 at which time it was sold to Opsware, Inc. in a stock and debt for stock exchange. The Company recorded an \$8.5 million gain on the transaction, which is included in Other Income, Net in the Consolidated Statements of Operations for the year ended December 31, 2004.

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

The Company's ownership interests in its companies are accounted for under three methods: consolidation, equity or cost. The applicable accounting method is generally determined based on the Company's voting interest in the entity.

*Consolidation Method.* The partner companies in which the Company directly or indirectly owns more than 50% of the outstanding voting securities are accounted for under the consolidation method of accounting. Under this method, these partner companies' financial statements are included within the Company's Consolidated Financial Statements. All significant intercompany accounts and transactions have been eliminated. Participation of other shareholders in the net assets and in the income or losses of these consolidated companies is reflected in Minority Interest in the Consolidated Balance Sheets and Statements of Operations. Minority 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. However, if there is no minority interest balance remaining on the Consolidated Balance Sheets related to the respective company, the Company records 100% of the consolidated partner company's losses; the Company records 100% of subsequent earnings of the partner company to the extent of such previously recognized losses in the excess of the Company's proportionate share. The results of operations and cash flows of a consolidated company are included through the latest interim period in which the Company owned a 50% or greater voting interest. Upon dilution of control below 50%, the accounting method is adjusted to either the equity or cost method of accounting.

*Equity Method.* The partner companies whose results are not consolidated, but over whom the Company exercises significant influence, are accounted for 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 on the partner company's board of directors and 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 respective general and limited partner interests. Under the equity method of accounting, a partner company's financial statements are not reflected within the Company's Consolidated Financial Statements, however, the Company's share of the income or loss of the partner company is reflected in Equity Loss in the Consolidated Statements of Operations. The carrying value of equity method companies is included in Ownership Interests In and Advances to Companies on the Consolidated Balance Sheets. The Company reports 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.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

When the Company's investment in an equity method partner company is reduced to zero, no further losses are recorded in the Company's Consolidated Statements of Operations unless the Company has outstanding guarantee obligations or has committed additional funding to the equity method company. When the equity method company subsequently reports income, the Company will not record its share of such income until it equals the amount of the Company's share of losses not previously recognized.

*Cost Method.* Companies not consolidated or accounted for under the equity method are accounted for under the cost method of accounting. Under the cost method, the Company's share of the income or losses of such partner companies is not included in the Company's Consolidated Statements of Operations. The carrying value of cost method companies is included in Ownership Interests In and Advances to Companies on the Consolidated Balance Sheets.

In addition to the Company's holdings in voting and non-voting equity and debt securities, it also periodically makes advances to its partner companies in the form of promissory notes which are accounted for in accordance with Statement of Financial Accounting Standards (SFAS) No. 114, "Accounting By Creditors for Impairment of a Loan."

*Impairment.* On a continuous basis, but no less frequently than at the end of each quarterly period, the Company evaluates the carrying value of its equity and cost method partner companies 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 carrying value of its ownership interest in the company. Impairment is measured by the amount by which the carrying amount of the assets exceeds their fair values.

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 is generally determined based on the value of its pro rata portion of the fair value of the funds' net assets.

Impairment charges related to goodwill of consolidated partner companies are included in Goodwill Impairment in the Consolidated Statements of Operations. Impairment charges related to equity method companies are included in Equity Loss in the Consolidated Statements of Operations. Impairment charges related to cost method companies are included in Other Income, Net in the Consolidated Statements of Operations.

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

***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 companies and investments in marketable securities, the evaluation of the recoverability of goodwill, intangible assets and property and equipment, revenue recognition, income taxes, stock-based compensation and commitments and contingencies.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Certain amounts recorded to reflect the Company's share of losses of 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 made final.

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 companies, goodwill and intangible assets and the estimated useful life of amortizable intangible assets could change in the near term and that the effect of such changes on the financial statements could be material. At December 31, 2006, the Company believes the recorded amount of carrying value of the Company's ownership interests in and advances to companies, goodwill and intangible assets 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.

***Reclassifications***

Certain prior year amounts have been reclassified to conform to the current year presentation including the reclassification to discontinued operations of Mantas which was sold in October 2006, Alliance Consulting's Southwest region which was sold in May 2006, Laureate Pharma's Totowa, New Jersey operation which was sold in December 2005 and CompuCom which was sold in October 2004. The impact of these reclassifications did not affect the Company's net income (loss).

The Company has separately disclosed the operating, investing and financing portions of the cash flows attributable to its discontinued operations. Included in these amounts were net cash flows of \$0.1 million, \$0.7 million and \$2.2 million in 2006, 2005 and 2004, respectively, attributable to Alliance Consulting's Southwest region and the Laureate Pharma Totowa operation. Because these businesses did not maintain separate bank accounts, any net cash provided by (used in) these businesses increased (decreased) the cash and cash equivalents balance of the Company's continuing operations as shown on the Consolidated Balance Sheets. Cash flows related to Mantas in 2006, 2005, and 2004 and CompuCom in 2004 are adjusted in our Statement of Cash Flows to reconcile to cash and cash equivalents associated with continuing operations.

***Cash and Cash Equivalents, Short-Term Marketable Securities and Restricted Cash***

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. Short-term marketable securities consist of held-to-maturity securities, primarily consisting of commercial paper and certificates of deposits. Restricted cash is primarily invested in money market instruments.

***Restricted Marketable Securities***

Restricted marketable securities include held-to-maturity securities, as it is the Company's ability and intent to hold these securities to maturity. The securities are U.S. Treasury securities with various maturity dates. Pursuant to terms of the 2.625% convertible senior debentures due March 15, 2024 ("2024 Debentures") as a result of the sale of CompuCom in 2004, the Company pledged the securities to an escrow agent for interest payments through March 15, 2009 on the 2024 Debentures resulting in their classification as restricted on the Consolidated Balance Sheets (See Note 4).

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Long-Term Marketable Securities***

The Company records its ownership interest in cost method equity securities that have readily determinable fair value as available-for-sale or trading securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity 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 shareholders' equity. Unrealized losses are charged against net loss when a decline in the fair value is determined to be other than temporary. Trading securities are carried at fair value, based on quoted market prices, with the unrealized gain or loss included in Other Income, Net, in the Consolidated Statements of Operations. The Company records its ownership interest in debt securities at amortized cost because it has the ability and intent to hold these securities until maturity.

***Financial Instruments***

The Company's financial instruments, principally cash and cash equivalents, restricted cash, marketable securities, restricted marketable securities, 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 long-term debt is carried at cost which approximates fair value as the debt bears interest at rates approximating current market rates. At December 31, 2006, the market value of the Company's 2024 Debentures was approximately \$104 million based on quoted market prices.

***Property and Equipment***

Property and equipment are stated at cost. Equipment under capital leases is stated at the present value of minimum lease payments. 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.

***Intangible Assets, net***

Intangible assets with indefinite useful lives are not amortized but instead are tested for impairment at least annually, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Intangible assets with definite useful lives are amortized over their respective estimated useful lives to their estimated residual value.

Purchased in-process research and development ("IPR&D") represents the value assigned in a purchase business combination to research and development projects of the acquired business that had commenced but had not yet been completed at the date of acquisition and which have no alternative future use. In accordance with SFAS No. 2, "Accounting for Research and Development Costs," as clarified by FASB Interpretation No. 4, "Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method," amounts assigned to IPR&D meeting the above criteria must be charged to expense as part of the allocation of the purchase price of the business combination.

***Goodwill***

Goodwill is tested for impairment at least annually, in accordance with SFAS No. 142.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed of***

In accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” the Company reviews long-lived assets, including property and equipment and amortizable intangibles, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to forecasted undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

***Recoverability of Note Receivable — Related Party***

The Company evaluates the recoverability of its Note Receivable — Related Party in accordance with SFAS No. 114 “Accounting by Creditors for Impairment of a Loan — an Amendment of FASB Statements No. 5 and 15”. Under SFAS No. 114, a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment charges are included in Recovery (Impairment) — Related Party in the Consolidated Statements of Operations. The Company does not accrue interest when a note is considered impaired. All cash receipts from impaired notes are applied to reduce the original principal amount of such note until the principal has been fully recovered, and would be recognized as interest income thereafter. Cash receipts in excess of the carrying value of the note are recognized as a reduction of impairment expense until such time that the original principal has been recovered.

***Deferred Revenue***

Deferred revenue represents cash collections on contracts in advance of performance of services or delivery of products and is recognized as revenue when the related services are performed or products are delivered.

***Revenue Recognition***

During 2006, 2005 and 2004, the Company’s revenue from continuing operations was primarily attributable to Acsis (since December 2005), Alliance Consulting, Clariant, Laureate Pharma (since December 2004) and Pacific Title.

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

Acsis recognizes software fees in accordance with Statement of Position No. 97-2, “Software Revenue Recognition” (“SOP 97-2”), as amended. Although Acsis follows specific and detailed guidelines in measuring revenue, the application of those guidelines requires judgment including: (i) whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence of fair value exists for those elements; (ii) whether customizations or modifications of the software are significant; and (iii) whether collection of the software fee is probable. Additionally, Acsis specifically evaluates any other terms in its license transactions, including by not limited to, options to purchase additional software at a future date, extended payment terms and functionality commitments not delivered with the software. Acsis recognizes software license revenue when the following criteria are met: (1) a signed contract is obtained; (2) delivery of the products has occurred; (3) the license fee is fixed or determinable; and (4) collectibility is probable. Acsis generally recognizes license revenue using the “residual method” when there is vendor-specific objective evidence of the fair values of all undelivered elements in a multiple-element arrangement that is not accounted for using long-term contract accounting. For those contracts that contain significant customization or modifications, license revenue is recognized using the percentage-of-completion method.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Most of Acsis' software arrangements include professional services. Acsis provides professional services under service agreements on a time and material-basis or based on a fixed-price arrangement. The revenues from Acsis' time and material based professional consulting and implementation services are recognized as the work is performed, provided that the customer has a contractual obligation to pay, the fee is non-refundable and collection is probable. Delays in project implementation will result in delays in revenue recognition. Acsis recognizes revenues from professional consulting services under fixed-price arrangements using the proportional-performance method based on direct labor costs incurred to date as a percentage of total estimated labor costs required to complete the project. Revisions to the estimates are reflected in the period in which changes become known. Project losses are provided for in their entirety in the period they become known, without regard to the percentage-of-completion. If Acsis does not accurately estimate the resources required or the scope of work to be performed, or if Acsis does not manage their projects properly within the planned periods of time, then future consulting margins on its projects may be negatively affected or losses on existing contracts may need to be recognized.

Hardware revenue is generated from the resale of a variety of hardware products, developed and manufactured primarily by third parties, which are integrated with and complementary to Acsis' software solutions. These products include computer equipment, RFID chip readers, bar code printers and scanners and other peripherals. Acsis generally purchase hardware from its vendors only after receiving an order from a customer, and revenue is recognized upon shipment by the vendor to the customer unless the hardware is an element in an arrangement that includes services that involve significant customization or modifications to software, in which case, hardware revenue is bundled with the software and services are recognized on a percentage-of-completion basis.

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

Clariant generates revenue from diagnostic services, system sales and fee-per-use charges. Clariant recognizes revenue for diagnostic services at the time of completion of services at amounts equal to the contractual rates allowed from third parties including Medicare, insurance companies and, to a small degree, private patients. These expected amounts are based both on Medicare allowable rates and Clariant's collection experience with other third party payors. Clariant recognizes revenue for fee-per-use agreements based on the greater of actual usage fees or the minimum monthly rental fee. Under this pricing model, Clariant owns most of the ACIS instruments that are engaged in service and, accordingly, all related depreciation and maintenance and service costs are expensed as incurred.

Revenue for instruments that are sold is recognized and deferred using the residual method pursuant to the requirements of Statement of Position No. 97-2, "Software Revenue Recognition" (SOP 97-2), as amended by Statement of Position No. 98-9, "Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Arrangements." At the outset of the arrangement with the customer, Clariant defers revenue for the fair value of its undelivered elements (e.g., maintenance) and recognizes revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (e.g., software license) when the basic criteria in SOP 97-2 have been met. Maintenance revenue is recognized ratably over the term of the maintenance contract, typically twelve months.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Systems sold under a leasing arrangement are accounted for as sales-type leases pursuant to SFAS No. 13, "Accounting for Leases," if applicable. Clariant recognizes the net effect of these transactions as a sale because of the bargain purchase option granted to the lessee.

Clariant has entered into a distribution and development agreement with Dako, which includes multiple elements. Those elements include distribution rights, ACIS instruments, research and development services, training and maintenance. The agreement calls for an upfront payment and additional payments as instruments are delivered or milestones are achieved under the research and development component. Clariant accounts for this arrangement under the percentage-of-completion method using the zero profit margin approach. Under this approach, revenue is recognized in amounts equal to the costs incurred to provide the products and services. Clariant further limits the amount of revenue recognized to the amount of fees that are fixed or determinable under the agreement. Because Clariant does not have evidence of fair value for certain elements that span the term of the agreement, the profit earned will be recognized over the remaining term of the agreement once the research and development services are complete. As of December 31, 2006, the research and development services were ongoing.

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

Pacific Title's revenue is primarily derived from providing archival, title and special effects services to the motion picture and television industry. Revenue is generally recognized upon the performance of services. Certain services are performed under fixed price contracts. Revenue from these contracts are recognized on a percentage-of-completion basis based on costs incurred to total estimated costs to be incurred. Any anticipated losses on contracts are expensed when identified.

***Defined Contribution Plans***

Defined contribution plans are contributory and cover eligible employees of the Company and certain subsidiaries. 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 determines the amount, if any, of the employer-paid matching contribution at the end of each calendar year. Additionally, the Company may make annual discretionary contributions under the plan based on a participant's eligible compensation. Certain subsidiaries also generally match from 25% to 50% of the first 3% to 6% of employee contributions to these plans. Amounts expensed relating to all plans were \$0.9 million in 2006, \$0.8 million in 2005 and \$0.5 million in 2004.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Income Taxes***

Income taxes are accounted for in accordance with SFAS No. 109, "Accounting 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. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Management 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***

Net income (loss) per share (EPS) is computed using the weighted average number of common shares outstanding during each year. Diluted EPS includes 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 public subsidiaries or equity companies.

***Comprehensive Income (Loss)***

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 which is used by management for making operating decisions and assessing performance as the source of the Company's reportable operating segments.

***New Accounting Pronouncements***

In September 2006, the United States Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 requires companies to evaluate the materiality of identified unadjusted errors using both the income statement approach and the balance sheet approach. In the initial year of adoption, if a company determines that an adjustment to prior year financial statements is required under either approach, SAB 108 allows for a one-time cumulative-effect adjustment to beginning retained earnings. SAB 108 is effective for interim periods of the first fiscal year ending after November 15, 2006. The adoption of SAB No. 108 did not have an impact on the Company's consolidated financial position, results of operations or cash flows.

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

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as “more-likely-than-not” to be sustained upon examination by the applicable taxing authority. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not believe adoption of FIN 48 will have a material effect on its consolidated financial position, results of operations or cash flows and will consist of reclassification of certain income tax-related liabilities.

In November 2005, the FASB issued FASB Staff Position SFAS 123(R)-3, “Transition Election Related to Accounting for the Tax Effects of Share-based Payment Awards”, that provides an elective alternative transition method of calculating the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R) (the “APIC Pool”) to the method otherwise required by paragraph 81 of SFAS No. 123(R). In the fourth quarter of 2006, the Company adopted the short-cut method to calculate the APIC Pool.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), “Share-Based Payment” (“SFAS No. 123(R)”). SFAS No. 123(R) requires companies to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. In addition, the adoption of SFAS No. 123(R) requires additional accounting and disclosure related to the income tax and cash flow effects resulting from share-based payment arrangements. The Company adopted SFAS No. 123(R) on January 1, 2006 using the modified prospective method. See Note 12.

## **2. Discontinued Operations**

### ***Mantas***

In October 2006, the Company completed the sale of its interest in Mantas for net cash proceeds of approximately \$112.8 million, including \$19.3 million held in escrow. The Company recorded a pre-tax gain of \$83.9 million in the fourth quarter of 2006. Mantas is reported in discontinued operations for all periods presented. Mantas sold its telecommunications business and certain related assets and liabilities in the first quarter of 2006 for \$2.1 million in cash. As a result of the sale, Mantas recorded a gain of \$1.9 million in the first quarter of 2006 which is also reported in discontinued operations. Goodwill of \$19.9 million related to Mantas was included in discontinued operations.

### ***Alliance Consulting — Southwest Region***

Alliance Consulting completed the sale of its Southwest region in May 2006 for proceeds of \$4.5 million, including cash of \$3.0 million and stock of the acquiror of \$1.5 million which was subsequently sold. As a result of the sale, Alliance Consulting recorded a gain of \$1.6 million in the second quarter of 2006. Alliance Consulting’s Southwest region is reported in discontinued operations for all periods presented. Goodwill of \$3.0 million related to the Southwest region was included in discontinued operations.

### ***Laureate Pharma — Totowa Facility***

In December 2005, Laureate Pharma sold its Totowa operations for \$16.0 million in cash. Laureate Pharma recognized a \$7.7 million gain on the transaction. The Totowa facility is reported in discontinued operations in 2005.

### ***CompuCom***

In October 2004, the Company completed the sale of its interest in CompuCom for approximately \$128 million in gross cash proceeds. The Company recorded a gain on the sale of approximately \$1.8 million in 2004.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

In connection with the sale:

- The Company provided a \$6.3 million letter of credit to the landlord of CompuCom's Dallas headquarters lease which will expire on March 19, 2019.
- In October 2004, the Company used approximately \$16.7 million of the proceeds to escrow interest payments due through March 15, 2009, on the Company's 2024 Debentures pursuant to the terms of the 2024 Debentures. A total of \$9.6 million is included in Restricted Marketable Securities on the Consolidated Balance Sheet at December 31, 2006, of which \$3.9 million is classified as a current asset. See Note 4.

In connection with this transaction the Company recognized in the Consolidated Financial Statements goodwill impairment of \$42.7 million, comprising \$33.4 million recorded by CompuCom in its operating results and \$9.3 million recorded by the Company, which is reported within discontinued operations for the year ended December 31, 2004.

Results of the discontinued operations were as follows:

	Year Ended December 31,		
	2006	2005 (in thousands)	2004
Revenue	\$ 29,476	\$ 49,223	\$ 983,501
Operating expenses	(27,050)	(50,813)	(983,636)
Goodwill impairment	—	—	(42,719)
Other	84	(29)	(1,488)
Income (loss) before income taxes and minority interest	2,510	(1,619)	(44,342)
Income tax (expense) benefit	(228)	(40)	2,928
Income (loss) before minority interest	2,282	(1,659)	(41,414)
Minority interest	—	—	10,137
Net income (loss) from operations	2,282	(1,659)	(31,277)
Gain on disposal, net of tax	87,528	7,697	1,798
Income (loss) from discontinued operations, net of tax	<u>\$ 89,810</u>	<u>\$ 6,038</u>	<u>\$ (29,479)</u>

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The assets and liabilities of discontinued operations were as follows:

	<u>December 31, 2005</u> (in thousands)
Cash	\$ 2,637
Restricted cash	250
Accounts receivable, less allowances	8,752
Other current assets	624
Total current assets	12,263
Property and equipment, net	1,954
Intangibles	306
Goodwill	22,867
Other assets	3,568
Total non-current assets	28,695
Total Assets	\$ 40,958
Current debt	\$ 1,506
Accounts payable	1,022
Accrued expenses	4,474
Deferred revenue	5,716
Total current liabilities	12,718
Other long-term liabilities	956
Total Liabilities	\$ 13,674
Carrying value	\$ 27,284

### 3. Business Combinations

#### *Acquisitions by the Company — 2006*

In November 2006, the Company acquired 32% of Advantedge Healthcare Solutions (“AHS”) for \$5.8 million in cash. AHS is a New York based technology-enabled service provider that delivers medical billing services to physician groups. The Company accounts for its holdings in AHS under the equity method.

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

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

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

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

In August 2006, the Company acquired 36% of Rubicor Medical, Inc. (“Rubicor”) for \$20 million in cash. Rubicor develops and distributes technologically advanced, disposable, minimally-invasive breast biopsy devices. The Company accounts for its holdings in Rubicor under the equity method. The difference between the Company’s cost and its interest in the underlying net assets of Rubicor has been allocated to in-process-research and development resulting in a \$0.6 million charge, which is reflected in Equity loss in the Consolidated Statement of Operations for 2006 and intangible assets as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheet.

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

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

***Acquisitions by the Company — 2005***

In December 2005, the Company acquired 94% of Acsis, Inc. for approximately \$26 million in cash plus options with a fair market value of \$1.7 million. Acsis provides enterprise data collection solutions to global manufacturers. The Acsis transaction was accounted for as a purchase and, accordingly, the Consolidated Financial Statements reflect the operations of Acsis from the acquisition date.

The following table summarizes the fair values of assets acquired and liabilities assumed:

	<b>Acsis</b>
	<b>(In thousands)</b>
Working capital	\$ 4,265
Property and equipment	1,263
Intangible assets	8,366
Purchased in-process research and development	1,974
Goodwill	11,534
Total purchase price	\$ 27,402

The intangible assets of Acsis consist of a covenant not-to-compete, with a one year life, developed technology, with a three year life, customer-related intangibles with a 10 year life, and a tradename with a 20 year life. Property and equipment are being depreciated over their weighted average lives (3 years to 5 years). The acquired in-process research and development costs were charged to earnings in 2005.

In November 2005, Clariant entered into a securities purchase agreement with a limited number of accredited investors pursuant to which Clariant agreed to issue shares of common stock and warrants to purchase additional shares of common stock for an aggregate purchase price of \$15 million. Of the total placement of \$15 million, the Company funded \$9 million to Clariant. The Company participated in the private placement to support the diagnostic services business line expansion as well as maintaining the Company’s controlling interest. Of the total purchase price, \$8.4 million was allocated to working capital, \$0.2 million was allocated to property and equipment, \$0.2 million was allocated to intangible assets and \$0.2 million was allocated to in-process research and development.

In April and June 2005, the Company acquired additional shares of Pacific Title from minority shareholders for a total of \$1.3 million, increasing its ownership in Pacific Title from 93% to 100%. Of the total purchase price, \$1.2 million was allocated to working capital and \$0.1 million was allocated to property and equipment.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*Acquisitions by Subsidiaries*

*Acquisitions by Subsidiaries — 2006*

In September 2006, Clariant completed the purchase of substantially all of the assets of Trestle Holdings, Inc. (“Trestle”) for approximately \$3.4 million of cash, assumed liabilities and transaction costs.

In July 2006, Alliance Consulting completed the acquisition of Fusion Technologies for \$5.6 million including \$5.3 million in cash and \$0.3 million in its stock.

The companies have not completed the allocations of purchase price for the acquisitions listed above. The following table summarizes the estimated fair values of assets acquired and liabilities assumed:

	<u>Alliance Consulting</u>	<u>Clariant</u>
	(In thousands)	
Working capital	\$ 70	\$ (34)
Property and equipment	443	76
Intangible assets	730	2,820
Goodwill	4,373	550
Total purchase price	<u>\$ 5,616</u>	<u>\$ 3,412</u>

The intangible assets acquired by Alliance Consulting consist of customer lists with a seven year life and property and equipment which are being depreciated over their weighted average lives (3 to 5 years). The intangible assets acquired by Clariant consist of developed technology with a 7 to 10 year life, a tradename with a 10 year life and other which consists of customer relationships and service with 10 to 15 year lives. Property and equipment of Clariant are being depreciated over their weighted average lives (3 years).

In October 2004, Alliance Consulting acquired 100% of the issued and outstanding stock of Mensamind, Inc. for approximately \$2.1 million, of which \$0.9 million was payable in cash and the remaining \$1.2 million in issuance of Alliance Consulting stock options, and transaction costs. Mensamind provides offshore IT consulting services. The Company has completed the allocation of purchase price for the acquisition of Mensamind. The following summarizes the fair values of assets and liabilities assumed.

	(in thousands)
Working capital	\$ (850)
Property and equipment	232
Intangible assets	1,500
Goodwill	1,327
Total purchase price	<u>\$ 2,209</u>

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**Pro Forma Financial Information**

The following unaudited pro forma financial information presents the combined results of operations of the Company as if the acquisitions had occurred as of the beginning of the periods presented, after giving effect to certain adjustments, including amortization of intangibles with definite useful lives. The pro forma results of operations are not indicative of the actual results that would have occurred had the acquisitions been consummated at the beginning of the period presented and are not intended to be a projection of future results.

	<b>Year Ended December 31,</b>	
	<b>2006</b>	<b>2005</b>
(In thousands except per share data)		
Total revenues	\$205,698	\$174,899
Net loss from continuing operations	\$(45,132)	\$(41,870)
Net loss per share from continuing operations — basic and diluted	\$ (0.37)	\$ (0.35)

**4. Marketable Securities**

Marketable securities included the following:

	<b>Current</b>		<b>Non Current</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
		(in thousands)	(in thousands)	
<b>Held-to-maturity:</b>				
Certificates of deposit	\$ —	\$ 12,289	\$ —	\$ —
U.S. Treasury securities	—	2,845	—	—
Mortgage and asset-backed securities	—	2,457	—	—
Commercial paper	94,155	14,179	—	—
	<u>94,155</u>	<u>31,770</u>	<u>—</u>	<u>—</u>
Restricted U.S. Treasury securities	3,869	3,805	5,737	9,457
	<u>98,024</u>	<u>35,575</u>	<u>5,737</u>	<u>9,457</u>
<b>Available-for-sale:</b>				
Equity securities	—	—	487	3,311
	<u>\$ 98,024</u>	<u>\$ 35,575</u>	<u>\$ 6,224</u>	<u>\$ 12,768</u>

As of December 31, 2006, the contractual maturities of securities were as follows:

	<b>Years to Maturity</b>			<b>Total</b>
	(in thousands)			
	Less Than One Year	One to Five Years	No Single Maturity Date	
Held-to-maturity	\$98,024	\$ 5,737	\$ —	\$103,761
Available-for-sale	—	—	487	487
	<u>\$98,024</u>	<u>\$ 5,737</u>	<u>\$ 487</u>	<u>\$104,248</u>

As of December 31, 2006 and December 31, 2005, the Company's investment in available-for-sale securities had generated, on a cumulative basis, unrealized gains of \$0.5 million and \$3.3 million, respectively, which are reflected in Accumulated Other Comprehensive Income on the Consolidated Balance Sheets. For the year ended December 31, 2006, the Company recorded unrealized losses of \$0.6 million, associated with the Company's investment in trading securities (sold in the fourth quarter of 2006), which are reflected in Other Income, Net in the Consolidated Statements of Operations.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**5. Property and Equipment**

Property and equipment consisted of the following:

	<u>As of December 31,</u>	
	<u>2006</u>	<u>2005</u>
	(In thousands)	
Building and improvements	\$ 23,484	\$ 17,483
Machinery and equipment	64,685	57,894
	<u>88,169</u>	<u>75,377</u>
Accumulated depreciation and amortization	(43,280)	(37,638)
	<u>\$ 44,889</u>	<u>\$ 37,739</u>

**6. Ownership Interests in and Advances to Companies**

The following summarizes the carrying value of the Company's ownership interests in and advances to companies and funds accounted for under the equity method or cost method of accounting.

	<u>As of December 31,</u>	
	<u>2006</u>	<u>2005</u>
	(In thousands)	
Equity Method:		
Companies	\$ 32,155	\$ —
Private Equity Funds	5,290	5,877
	<u>37,445</u>	<u>5,877</u>
Cost Method:		
Companies	14,283	9,557
Private Equity Funds	2,820	2,463
	<u>\$ 54,548</u>	<u>\$ 17,897</u>

In 2005, the Company sold certain interests in private equity funds and recorded a gain of \$7 million. Following the sale, the Company retained an indirect interest in certain publicly-traded securities held by a private equity fund and the carried interest in a portion of its general partner interest in certain funds. During 2006, the Company received a distribution of the publicly-traded securities and sold these securities for a gain of \$0.1 million.

In 2004, the Company recorded impairment charges totaling \$3.7 million for companies and funds accounted for under the equity method. Impairment charges related to cost method companies were \$1.4 million and \$3.2 million for the years ended December 31, 2005 and 2004, respectively. The amount of each impairment charge was determined by comparing the carrying value of the company to its estimated fair value. Impairment charges associated with equity method companies are included in Equity Loss in the Consolidated Statements of Operations. Impairment charges related to cost method companies are included in Other Income, Net in the Consolidated Statements of Operations.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The following unaudited summarized financial information for our companies and funds accounted for under the equity method at December 31, 2006 and 2005 and for the three years ended December 31, 2006, 2005 and 2004, has been compiled from the unaudited financial statements of our respective companies and funds and reflects certain historical adjustments. Revenue and net loss of the companies and funds are excluded for periods prior to their acquisition and subsequent to their disposition.

	<u>As of December 31,</u>		
	<u>2006</u>	<u>2005</u>	
	(In thousands)		
<b>Balance Sheets:</b>			
Current assets	\$ 41,025	\$ 37,871	
Non-current assets	104,413	121,190	
Total Assets	<u>\$145,438</u>	<u>\$159,061</u>	
Current liabilities	\$ 6,021	\$ 20,133	
Non-current liabilities	310	1,436	
Shareholders' equity	139,107	137,492	
Total Liabilities and Shareholders' Equity	<u>\$145,438</u>	<u>\$159,061</u>	
	<u>Year Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(In thousands)		
<b>Results of Operations:</b>			
Revenue	<u>\$ 956</u>	<u>\$ 14,772</u>	<u>\$ 7,509</u>
Net Loss	<u>\$(25,544)</u>	<u>\$(35,302)</u>	<u>\$(64,713)</u>

The Company reports its share of the income or loss of the equity method partner companies on a one quarter lag.

### 7. Goodwill and Other Intangible Assets

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

	<u>Alliance Consulting</u>	<u>Clariant</u>	<u>Acsis</u>	<u>Total</u>
Balance at December 31, 2004	\$ 51,627	\$ 14,259	\$ —	\$ 65,886
Additions	—	—	11,931	11,931
Purchase price adjustments <sup>(1)</sup>	155	—	—	155
Balance at December 31, 2005	51,782	14,259	11,931	77,972
Additions	4,373	550	—	4,923
Purchase price adjustments <sup>(1)</sup>	—	—	(397)	(397)
Balance at December 31, 2006	<u>\$ 56,155</u>	<u>\$ 14,809</u>	<u>\$ 11,534</u>	<u>\$ 82,498</u>

<sup>(1)</sup> The above purchase price adjustments represent activity to complete the final purchase price allocation.

As discussed in Note 3, certain purchase price adjustments are not final.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

	Amortization Period	December 31, 2006		
		Gross Carrying Value	Accumulated Amortization	Net
(In thousands)				
Customer-related	7 — 10 years	\$10,089	\$ 2,737	\$ 7,352
Technology-related	3 — 10 years	9,914	6,412	3,502
Process-related	3 years	1,363	984	379
Trade names	10 — 20 years	1,372	70	1,302
Covenant not-to-compete	1 year	470	470	—
Other	10 — 15 years	1,350	26	1,324
		<u>24,558</u>	<u>10,699</u>	<u>13,859</u>
Trade names	Indefinite	2,567	—	2,567
Total		<u>\$27,125</u>	<u>\$ 10,699</u>	<u>\$16,426</u>

	Amortization Period	December 31, 2005		
		Gross Carrying Value	Accumulated Amortization	Net
(In thousands)				
Customer-related	7 — 10-years	\$ 8,991	\$ 1,626	\$ 7,365
Technology-related	3 — 10 years	7,993	5,094	2,899
Process-related	3 years	1,363	530	833
Trade names	20 years	1,222	5	1,217
Covenant not-to-compete	1 year	470	39	431
		<u>20,039</u>	<u>7,294</u>	<u>12,745</u>
Trade names	Indefinite	2,567	—	2,567
Total		<u>\$22,606</u>	<u>\$ 7,294</u>	<u>\$15,312</u>

Amortization expense related to intangible assets was \$3.4 million, \$2.4 million and \$2.2 million for the years ended December 31, 2006, 2005 and 2004, respectively. The following table provides estimated future amortization expense related to intangible assets (assuming there is not a writedown associated with these intangible assets causing an acceleration of expense):

	Total (In thousands)
2007	\$ 2,687
2008	2,269
2009	1,808
2010	1,225
2011 and thereafter	5,870
	<u>\$ 13,859</u>

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**8. Long-term Debt and Credit Arrangements**

Consolidated long-term debt consisted of the following:

	<b>As of December 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>	
Subsidiary credit line borrowings (guaranteed by the Company)	\$ 22,546	\$ 13,023
Subsidiary credit line borrowings (not guaranteed by the Company)	2,468	—
Subsidiary term loans (guaranteed by the Company)	3,000	4,000
	<u>28,014</u>	<u>17,023</u>
Other borrowings	1,861	849
Capital lease obligations	4,144	3,695
	<u>34,019</u>	<u>21,567</u>
Less current maturities	(28,952)	(16,397)
Total long-term debt, less current portion	<u>\$ 5,067</u>	<u>\$ 5,170</u>

In May 2006, the Company renewed its revolving credit facility that provides for borrowings and issuances of letters of credit and guarantees of up to \$55 million. Borrowing availability under the facility is reduced by the amounts outstanding for the Company's borrowings and letters of credit and amounts guaranteed under partner company facilities maintained with that same lender. This credit facility matures in May 2007 and bears interest at the prime rate (8.25% at December 31, 2006) for outstanding borrowings. The credit facility is subject to an unused commitment fee of 0.125%, which is subject to reduction based on deposits maintained at the bank. The facility requires cash collateral equal to one times the Company's borrowings and letters of credit and amounts borrowed by partner company facilities maintained with that same bank. As of December 31, 2006, three subsidiaries were not in compliance with certain financial covenants under their respective facilities and subsequently received waivers from the lender.

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

Availability under the revolving credit facilities at December 31, 2006 was as follows:

	<b>Total</b>
Size of facilities	\$ 75,000
Subsidiary facilities at same banks (a)	(28,000)
Outstanding letter of credit (b)	(6,336)
Amount available at December 31, 2006	<u>\$ 40,664</u>

- (a) The Company's ability to borrow under its credit facilities is limited by the amounts outstanding for the Company's borrowings and letters of credit and amounts guaranteed under partner company facilities maintained at the same respective banks. Of the total facilities, \$25.5 million was outstanding under these facilities at December 31, 2006 and was included as debt on the Consolidated Balance Sheet.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

As a result of the sale of the Company's holdings in Mantas in October 2006, the Company's guarantee related to the Mantas facility was released in September 2006, thereby increasing the Company's availability under its credit facility by \$3.5 million.

On February 28, 2007, all subsidiary facilities were extended for one year, with the exception of Acsis' facility, which expires in August 2008 and Pacific Title's facility which was not renewed by Pacific Title and under which there were no borrowings. In addition to the extension of the maturity dates, a subsidiary's working capital line was increased by \$5.5 million and that same subsidiary entered into a \$6 million equipment facility, all of which the Company guaranteed. Our \$10 million guarantee on a subsidiary facility was decreased to \$5 million and related interest rates on outstanding borrowings were also changed. In January 2007, Clariant increased its facility by \$3.5 million, all of which was guaranteed by the Company. As a result of these amendments, the Company's availability under the facilities has decreased by \$10.3 million. Availability under the facilities at March 22, 2007 was \$30.4 million.

Borrowings are secured by substantially all of the assets of the respective subsidiaries. These obligations bear interest at variable rates ranging between the prime rate minus 0.5% and the prime rate plus 1.0%. These facilities contain financial and non-financial covenants.

In September 2006, Clariant entered into a \$5 million senior secured revolving credit agreement. Borrowing availability under the agreement is based on the level of Clariant's qualified accounts receivable, less certain reserves. The agreement has a two-year term and bears interest at variable rates based on the lower of LIBOR plus 3.25% or the prime rate plus 0.5%. As of December 31, 2006, Clariant borrowed \$2.5 million and had no availability under this facility based on the level of qualified accounts receivable. As of December 31, 2006, Clariant was not in compliance with a financial covenant under this agreement and subsequently received a waiver from the lender.

Debt as of December 31, 2006 bore interest at fixed rates between 4.62% and 20.33% and variable rates indexed to the prime rate plus 1.75%. Debt as of December 31, 2005 bore interest at fixed rates between 4.0% and 22% and variable rates indexed to the prime rate plus 1.75%.

The Company's debt matures as follows:

	<b>Total</b>
	<b>(In thousands)</b>
2007	\$ 28,952
2008	3,154
2009	1,898
2010	15
2011 and thereafter	—
Total debt	\$ 34,019

### 9. Convertible Subordinated Notes and Convertible Senior Debentures

In June 1999, the Company issued \$200 million of 5% convertible subordinated notes due June 15, 2006. During 2004, the Company repurchased or redeemed all of these 2006 Notes for an aggregate cost of \$201.4 million, including transaction costs. The Company recorded \$1.8 million of expense for the year ended December 31, 2004 related to the acceleration of deferred debt issuance costs associated with the 2006 Notes, which is included in Other Income, Net in the Consolidated Statements of Operations.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

In February 2004, the Company completed the sale of \$150 million of 2.625% convertible senior debentures with a stated maturity of March 15, 2024. Interest on these 2024 Debentures is payable semi-annually. At the debenture holders' option, the 2024 Debentures are convertible into our common stock through March 14, 2024, subject to certain conditions. The conversion rate of the debentures at December 31, 2006 was \$7.2174 of principal amount per share. The closing price of the Company's common stock at December 31, 2006 was \$2.42. At December 31, 2006, the market value of the 2024 Debentures was approximately \$104 million based on quoted market prices. The 2024 Debenture holders may require the Company to repurchase the 2024 Debentures on March 21, 2011, March 20, 2014 or March 20, 2019 at a repurchase price equal to 100% of their respective face amount plus accrued and unpaid interest. The 2024 Debenture holders may also require repurchase of the 2024 Debentures upon certain events, including sale of all or substantially all of our common stock or assets, liquidation, dissolution or a change in control. Subject to certain conditions, the Company may redeem all or some of the 2024 Debentures commencing March 20, 2009. During 2006, the Company repurchased \$21 million of face value of the 2024 Debentures for \$16.4 million in cash, including accrued interest. The Company recorded \$0.4 million of expense related to the acceleration of deferred debt issuance costs associated with the 2024 Debentures, resulting in a net gain of \$4.3 million, which is included in Other Income, Net in the Consolidated Statements of Operations.

As required by the terms of the 2024 Debentures, after completing the sale of CompuCom, the Company escrowed \$16.7 million on October 8, 2004 for interest payments through March 15, 2009 on the 2024 Debentures (see Notes 2 and 4). A total of \$9.6 million is included in Restricted Marketable Securities on the Consolidated Balance Sheet at December 31, 2006, of which \$3.9 million is classified as a current asset.

#### 10. Accrued Expenses and Other Current Liabilities

Accrued expenses consisted of the following:

	As of December 31,	
	2006	2005
	(In thousands)	
Accrued professional fees	\$ 2,925	\$ 2,727
Other	16,240	11,840
	\$ 19,165	\$ 14,567

#### 11. Shareholders' 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, 2006 and 2005, there were one million shares authorized and none outstanding.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***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 equivalent in voting and dividend rights to one share of the Company's common stock. The rights will be exercisable only if a person or group acquires beneficial ownership of 15% or more of the Company's common stock or commences a tender or exchange offer that would result in such a person or group owning 15% or more of the Company's common stock. If the rights do become exercisable, the Company's shareholders, other than the shareholders that caused the rights to become exercisable, will be able to exercise each right at an exercise price of \$300 and receive shares of the Company's common stock having a market value equal to approximately twice the exercise price. As an alternative to paying the exercise price in cash, if the directors of the Company so determine, shareholders may elect to exercise their rights and, without the payment of any exercise price, receive half the number of shares of common stock that would have been received had the exercise price been paid in cash.

**12. Stock-Based Compensation**

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

***Equity Compensation Plans***

The Company has three equity compensation plans: the 1999 Equity Compensation Plan, with 9.0 million shares authorized for issuance; the 2001 Associates Equity Compensation Plan with 5.4 million shares authorized for issuance; and the 2004 Equity Compensation Plan, with 6.0 million shares authorized for issuance. Employees and consultants are eligible for grants of stock options, restricted stock awards, stock appreciation rights, stock units, performance units and other stock-based awards under each of these plans; directors and executive officers are eligible for grants only under the 1999 and 2004 Equity Compensation Plans. During 2005, 6.0 million options also were awarded outside of existing plans as inducement awards in accordance with New York Stock Exchange rules.

To the extent allowable, all grants are incentive stock options. Options granted under the plans are at prices equal to 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, 2006, the Company had reserved 23.4 million shares of common stock for possible future issuance under its equity compensation plans. Several subsidiaries also maintain separate equity compensation plans for their employees, directors and advisors.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**Classification of Stock-Based Compensation Expense**

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

	<u>Year Ended December 31, 2006</u> (in thousands)
Cost of sales	\$ 85
Selling, general and administrative	6,640
Research and development	117
	<u>\$ 6,842</u>

Prior to adopting SFAS No. 123(R), the Company accounted for stock-based compensation in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." Had compensation cost been recognized consistent with SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's consolidated net loss from continuing operations and discontinued operations and loss per share from continuing operations and from discontinued operations would have been as follows:

		<u>Year Ended December 31, 2005</u> (in thousands, except per share data)	<u>Year Ended December 31, 2004</u>
Consolidated net loss from continuing operations	As reported	\$ (38,108)	\$ (25,341)
Add: Stock-based compensation expense included in net loss, net of minority interest	As reported	2,439	3,878
Deduct: Total stock based employee compensation expense from continuing operations determined under fair value based method for all awards, net of related tax effects		<u>(7,927)</u>	<u>(8,418)</u>
Consolidated net loss from continuing operations	Pro forma	(43,596)	(29,881)
Net income (loss) from discontinued operations	As reported	6,038	(29,479)
Deduct: Total stock based employee compensation expense from discontinued operations determined under fair value based method for all awards, net of related tax effects		<u>(379)</u>	<u>(760)</u>
	Pro forma	<u>\$ (37,937)</u>	<u>\$ (60,120)</u>
<b>Basic and Diluted Income (Loss) Per Share:</b>			
Net loss from continuing operations	As reported	\$ (0.32)	\$ (0.21)
Net income (loss) from discontinued operations	As reported	<u>0.05</u>	<u>(0.25)</u>
		<u>\$ (0.27)</u>	<u>\$ (0.46)</u>
Net loss from continuing operations	Pro forma	\$ (0.36)	\$ (0.25)
Net income (loss) from discontinued operations	Pro forma	<u>0.04</u>	<u>(0.25)</u>
		<u>\$ (0.32)</u>	<u>\$ (0.50)</u>

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**The Company**

The fair value of the Company's stock-based awards to employees during the years ended December 31, 2006, 2005 and 2004 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 life of stock options granted was estimated using the historical exercise behavior of employees. Expected volatility was based on historical volatility for a period equal to the stock option's expected life.

	Year Ended December 31,		
	2006	2005	2004
<b>Service-Based Awards</b>			
Dividend yield	0%	0%	0%
Expected volatility	69%	84%	86%
Average expected option life	5 years	5 years	5 years
Risk-free interest rate	4.7%	4.4%	3.6%
	Year Ended December 31,		
	2006	2005	
<b>Market-Based Awards</b>			
Dividend yield	0%	0%	
Expected volatility	62%	67%	
Average expected option life	5 — 7 years	5 — 7 years	
Risk-free interest rate	4.8%	4.3%	

The weighted-average grant date fair value of options issued by the Company during the years ended December 31, 2006, 2005 and 2004 was \$1.36, \$0.95 and \$1.45 per share, respectively.

The Company granted 1.6 million market-based stock option awards to employees during the year ended December 31, 2006 and 8.6 million market-based stock option awards during the year ended December 31, 2005. The awards entitle participants to vest in a number of options determined by achievement of certain target market capitalization increases (measured by reference to stock price increases on a specified number of outstanding shares) over an eight-year period. The requisite service periods for the market-based awards are based on the Company's estimate of the dates on which the market conditions will be met as determined using a Monte Carlo simulation model. Compensation expense is recognized over the requisite service periods using the straight-line method, but is accelerated if market capitalization targets are achieved earlier than estimated. Based on the achievement of market capitalization targets, 1.7 million shares vested during the year ended December 31, 2006. During the year ended December 31, 2006, 0.8 million market-based awards were forfeited. The Company recorded \$1.9 million of compensation expense related to the market-based awards in the year ended December 31, 2006. The maximum number of unvested shares at December 31, 2006 attainable under these grants is 7.6 million shares.

All other outstanding options are service-based awards that generally vest over four years after the date of grant and expire eight years after the date of grant. Compensation expense is recognized over the requisite service period using the straight-line method. The requisite service period for service-based awards is the period over which the award vests. The Company recorded \$2.0 million of compensation expense related to these awards during the year ended December 31, 2006.

During the year ended December 31, 2006, the Company granted 21 thousand stock options to members of its advisory boards, which comprise non-employees. Such awards vest over one year, are equity classified and are marked-to-market each period.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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, 2003	10,319	\$ 8.10		
Options granted	2,719	2.09		
Options exercised	(442)	3.15		
Options canceled/forfeited	(3,380)	14.69		
Outstanding at December 31, 2004	9,216	4.15		
Options granted	10,924	1.44		
Options exercised	(44)	1.39		
Options canceled/forfeited	(1,125)	10.82		
Outstanding at December 31, 2005	18,971	2.20		
Options granted	2,723	2.19		
Options exercised	(238)	1.58		
Options canceled/forfeited	(2,728)	3.74		
Outstanding at December 31, 2006	<u>18,728</u>	1.98	6.0	\$11,456
Options exercisable at December 31, 2006	8,063	2.42	4.9	3,848
Options vested and expected to vest at December 31, 2006	13,065	2.15	5.6	7,193
Shares available for future grant	3,359			

The total intrinsic value of options exercised for the year ended December 31, 2006 was \$0.2 million.

At December 31, 2006, total unrecognized compensation cost related to non-vested stock options granted under the plans for service-based awards was \$2.7 million. That cost is expected to be recognized over a weighted-average period of 2.3 years.

At December 31, 2006, total unrecognized compensation cost related to non-vested stock options granted under the plans for market-based awards was \$3.9 million. That cost is expected to be recognized over a weighted-average period of 4.5 years but would be accelerated if market capitalization targets are achieved earlier than estimated.

Total compensation expense for restricted stock issuances was approximately \$0.4 million and \$0.5 million for the years ended December 31, 2005 and 2004, respectively, including amounts recorded by consolidated subsidiaries. Unrecognized compensation expense related to restricted stock issuances was \$0.1 million at December 31, 2006.

The Company has previously issued deferred stock units to certain employees. The Company issued deferred stock units during the years ended December 31, 2006 and 2005, to directors who elected to defer all or a portion of directors' fees earned. Deferred stock units issued to directors in lieu of directors fees are 100% vested at grant; matching deferred stock units equal to 25% of directors' fees deferred vest one year following grant. Deferred stock units are payable in stock on a one-for-one basis. Payments in respect of the deferred stock units are generally distributable following termination of employment or service, death, permanent disability or retirement. Total compensation expense for deferred stock units was approximately \$0.4 million, \$1.0 million and \$2.2 million for the years ended December 31, 2006, 2005 and 2004, respectively, including amounts recorded by consolidated subsidiaries. Unrecognized compensation expense related to deferred stock units at December 31, 2006 is \$0.1 million. The total fair value of deferred stock units vested during the year ended December 31, 2006 was \$0.4 million.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Deferred stock unit and restricted stock activity is summarized below:

	Shares (In thousands)	Weighted Average Grant Date Fair Value
Unvested at December 31, 2005	204	\$3.17
Granted	83	2.26
Vested	(172)	2.56
Forfeited	(44)	4.41
Unvested at December 31, 2006	<u>71</u>	2.82

### Consolidated Subsidiaries

The fair value of the Company's subsidiaries' stock-based awards issued to employees during the years ended December 31, 2006, 2005 and 2004 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 life of stock options granted was estimated using the historical exercise behavior of employees. The expected life of stock options granted for subsidiaries that do not have sufficient historical exercise behavior of employees was calculated using the simplified method of determining expected term as provided in Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB 107"). Expected volatility for publicly-held subsidiaries was based on historical volatility for a period equal to the stock option's expected life. Expected volatility for privately-held subsidiaries is based on the average historical volatility of comparable companies for a period equal to the stock option's expected life. The fair value of the underlying stock of privately-held subsidiaries on the date of grant was determined based on a number of valuation methods, including discounted cash flows and revenue and acquisition multiples.

	Year Ended December 31,		
	2006	2005	2004
Dividend yield	0%	0%	0%
Expected volatility	38% to 92%	50% to 103%	70% to 109%
Average expected option life	5 to 8 years	4 to 5 years	4 to 5 years
Risk-free interest rate	4.5% to 5.3 %	3.9% to 4.5 %	2.5 to 3.9%

Stock options granted by subsidiaries generally are service-based awards that vest four years after the date of grant and expire 7 to 10 years after the date of grant. Compensation expense is recognized over the requisite service period using the straight-line method. The requisite service period is the period over which the award vests. The Company's consolidated subsidiaries recorded \$2.8 million, \$1.4 million and \$2.0 million of stock-based compensation expense related to these awards during the years ended December 31, 2006, 2005 and 2004, respectively.

At December 31, 2006, total unrecognized compensation cost related to non-vested stock options granted under the consolidated subsidiaries' plans was \$4.3 million. That cost is expected to be recognized over a weighted-average period of 2.8 years.

During the year ended December 31, 2006, certain subsidiaries granted stock options to advisory boards, which comprise of non-employees. Such awards vest over four years, are equity classified and are marked-to-market each period.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Certain employees of the Company's subsidiaries have the right to require the respective subsidiary to purchase shares of common stock of the subsidiary received by the employee pursuant to the exercise of options or the conversion of deferred stock units. The employee must hold the shares for at least six months prior to exercising this right. The required purchase price is 75% to 100% of the fair market value at the time the right is exercised. These options and deferred stock units qualify for equity-classification under SFAS No. 123(R). In accordance with EITF Issue No. D-98, however, these instruments are classified outside of permanent equity on the Consolidated Balance Sheet as Redeemable Stock-Based Compensation at their current redemption amount based on the number of options and deferred stock units vested as of December 31, 2006.

**13. Other Income**

	Year Ended December 31,		
	2006	2005 (In thousands)	2004
Gain on sale of companies and funds, net	\$ 1,181	\$ 7,292	\$ 44,486
Gain (loss) on trading securities	321	(229)	(396)
Impairment charges	—	(1,425)	(3,197)
Other	4,071	1,700	(2,090)
	<u>\$ 5,573</u>	<u>\$ 7,338</u>	<u>\$ 38,803</u>

Gain on sale of companies and funds for the year ended December 31, 2006 of \$1.2 million primarily relates to the sale of a cost method investment whose carrying value was zero. Gain on sale of companies and funds for the year ended December 31, 2005 of \$7.3 million includes gains of sales of partnership interests in private equity funds in the third and fourth quarters of 2005. Total proceeds from the sales of certain interests in private equity funds during 2005 were \$27.6 million. As a result of the sale, the Company was also relieved of \$9.1 million of future fund commitments. Gain on sale of companies and funds for the year ended December 31, 2004 of \$44.5 million includes a gain of \$31.7 million related to the sale of our interest in Sanchez and \$8.5 million related to our sale of Tangram. Also included in gain on sale of companies and funds in 2004 is \$2.7 million attributable to a distribution from a bankruptcy proceeding and \$1.5 million relating to the final payment of an installment sale of a company sold in 1997. Total net cash proceeds for gains on sales of companies and funds was \$37.5 million for the year ended December 31, 2004.

Gain on trading securities in 2006 primarily reflects a net gain of \$0.4 million on the sale of our holdings in Traffic.com. Loss on trading securities in 2005 reflects the loss on the sale of our holdings in stock distributed from a private equity fund, which were sold in the third quarter of 2005. Loss on trading securities in 2004 primarily reflect the adjustment to fair value of our holdings in Opsware and subsequent loss on sale of Opsware stock of \$0.1 million.

We have recorded impairment charges for certain holdings accounted for under the cost method determined to have experienced an other than temporary decline in value in accordance with our existing policy regarding impairment of ownership interests in and advances to companies.

For the year ended December 31, 2006, the Company recognized a net gain of \$4.3 million on the repurchase of \$21 million of face value of the 2024 Debentures, which is included in Other above.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**14. Income Taxes**

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

	Year Ended December 31,		
	2006	2005	2004
	(In thousands)		
Current, primarily state	\$ (1,039)	\$ (83)	\$ (182)
Deferred, primarily state	16	—	62
	<u>\$ (1,023)</u>	<u>\$ (83)</u>	<u>\$ (120)</u>

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

	Year Ended December 31,		
	2006	2005	2004
Statutory tax benefit	(35.0)%	(35.0)%	(35.0)%
Increase (decrease) in taxes resulting from:			
State taxes, net of federal tax benefit	(2.3)	(0.2)	(0.5)
Non-deductible amortization	—	4.4	3.2
Valuation allowance	36.1	29.4	30.1
Other adjustments	(1.1)	1.2	1.7
	<u>(2.3)%</u>	<u>(0.2)%</u>	<u>(0.5)%</u>

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

	As of December 31,	
	2006	2005
	(In thousands)	
Deferred tax asset (liability):		
Carrying values of subsidiaries / holdings	\$ 41,468	\$ 42,293
Tax loss and credit carryforwards	189,579	177,754
Accrued expenses	4,519	3,806
Intangible assets	(2,092)	(1,420)
Other	4,090	8,577
	<u>237,564</u>	<u>231,010</u>
Valuation allowance	(238,475)	(231,905)
Net deferred tax liability	<u>\$ (911)</u>	<u>\$ (895)</u>

The Company has not recognized gross deferred tax assets for the difference between the book and tax basis of its holdings in the stock of certain consolidated subsidiaries where we do not believe we will dispose of the asset in the foreseeable future.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

As of December 31, 2006, the Company had federal net operating loss carryforwards and federal capital loss carryforwards of approximately \$254 million and \$140 million, respectively. These carryforwards expire as follows:

	<b>Total</b>
	<b>(In thousands)</b>
2007	\$ 29,707
2008	102,564
2009	1,087
2010	14,656
2011 and thereafter	246,102
	\$ 394,116

Limitations on utilization of both the net operating loss carryforward and capital loss carryforward may apply.

In assessing the recoverability of deferred tax assets, management 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. In the event of a decrease in the valuation allowance in future years, a portion of the decrease will reduce the Company's recorded goodwill. This is due to deferred tax assets acquired as part of the purchase of a subsidiary which currently requires a valuation allowance.

Clariant, the Company's subsidiary which is not consolidated for tax return purposes, had additional federal net operating loss carryforwards of \$119 million, which expire in various amounts from 2011 to 2026. Limitations on utilization of the net operating loss carryforwards may apply. Accordingly, valuation allowances have been provided to account for the potential limitations on utilization of these tax benefits.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**15. Net Loss Per Share**

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

	Year Ended December 31,		
	2006	2005	2004
(In thousands except per share data)			
<b>Basic:</b>			
Net loss from continuing operations	\$ (43,780)	\$ (38,108)	\$ (25,341)
Net income (loss) from discontinued operations	89,810	6,038	(29,479)
Net income (loss)	<u>\$ 46,030</u>	<u>\$ (32,070)</u>	<u>\$ (54,820)</u>
Average common shares outstanding	<u>121,476</u>	<u>120,845</u>	<u>119,965</u>
Net loss per share from continuing operations	\$ (0.36)	\$ (0.32)	\$ (0.21)
Net income (loss) per share from discontinued operations	0.74	0.05	(0.25)
Net income (loss) per share	<u>\$ 0.38</u>	<u>\$ (0.27)</u>	<u>\$ (0.46)</u>
<b>Diluted:</b>			
Net loss from continuing operations	\$ (43,780)	\$ (38,108)	\$ (25,341)
Net income (loss) from discontinued operations	89,810	6,038	(29,479)
	46,030	(32,070)	(54,820)
Effect of holdings	(126)	(106)	—
Adjusted net income (loss)	<u>\$ 45,904</u>	<u>\$ (32,176)</u>	<u>\$ (54,820)</u>
Average common shares outstanding	<u>121,476</u>	<u>120,845</u>	<u>119,965</u>
Net loss per share from continuing operations	\$ (0.36)	\$ (0.32)	\$ (0.21)
Net income (loss) per share from discontinued operations	0.74	0.05	(0.25)
Diluted income (loss) per share	<u>\$ 0.38</u>	<u>\$ (0.27)</u>	<u>\$ (0.46)</u>

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

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

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

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

- At December 31, 2006, 2005 and 2004, options to purchase 18.7 million, 19.0 million and 9.2 million shares of common stock, respectively, at prices ranging from \$1.03 to \$45.47 per share, were excluded from the calculation.
- At December 31, 2006, 2005 and 2004, unvested restricted stock units and DSUs convertible into 0.1 million, 0.2 million and 0.8 million shares of stock, respectively, were excluded from the calculations.
- At December 31, 2004, a total of 3.4 million shares related to the Company's 2006 Notes (See Note 9) representing the weighted average effect of assumed conversion of the 2006 Notes were excluded from the calculation.
- At December 31, 2006 and 2005, a total of 19.3 million and 20.8 million shares related to the Company's 2024 Debentures (See Note 9) representing the weighted average effect of assumed conversion of the 2024 Debentures were excluded from the calculation.

**16. Related Party Transactions**

In October 2000, the Company guaranteed certain margin loans advanced by a third party to Mr. Musser, then the Chief Executive Officer of the Company. The securities subject to the margin account included shares of the Company's common stock. The Company entered into this guarantee arrangement to maintain an orderly trading market for its equity securities, to maintain its compliance posture with the Investment Company Act of 1940, and to avoid diversion of the attention of a key executive from the performance of his responsibilities to the Company. In May 2001, the Company entered into a \$26.5 million loan agreement with Mr. Musser. The proceeds of the loan were used to repay the margin loans guaranteed by the Company in October 2000. The purpose of the May 2001 loan agreement was to eliminate the guarantee obligations and to provide for direct and senior access to Mr. Musser's assets as collateral for the loan. The Company demanded repayment in January 2003 and, when no payment was received, declared a default. Based on the information available to us, the Company concluded that Mr. Musser may not have sufficient personal assets to satisfy the outstanding balance due under the loan. Through September 30, 2006, the Company had impaired the loan over time by an aggregate of \$15.7 million to the estimated value of the collateral.

In December 2006, the Company restructured the obligation to reduce the amount outstanding to \$14.8 million, bearing interest at a rate of 5% per annum, in order to obtain new collateral, which is expected to be the primary source of repayment, along with additional collateral required to be provided to the Company over time. Cash payments, when received, will reduce the carrying value of the note, and thereafter, will be recognized as Recovery-related party in the Consolidated Statements of Operations. Subsequent to the restructuring of the obligation and prior to December 31, 2006, the Company received cash of approximately \$1.0 million from the sale of collateral, which exceeded its then carrying value of the loan. The excess of \$0.4 million is reflected as Recovery-related party in the Consolidated Statements of Operations. The carrying value of the loan at December 31, 2006 is 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.

The Company's Chairman is the President and CEO of TL Ventures. The Company had invested or committed a total of \$67 million in the seven TL Ventures and EnerTech Capital funds. The Company owned less than 7% of the partnership interests of each of these funds prior to the sale of certain interests the Company had in the funds.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

As described in Note 13, the Company sold certain holdings in private equity funds in the fourth quarter of 2005 to a third party.

**17. Commitments and Contingencies**

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

The Company and its subsidiaries conduct a portion of their operations in leased facilities and lease machinery and equipment under leases expiring at various dates to 2015. Total rental expenses under operating leases was \$5.8 million, \$6.3 million and \$5.4 million in 2006, 2005 and 2004, respectively. Future minimum lease payments under non-cancelable operating leases with initial or remaining terms of one year or more at December 31, 2006, are (in millions): \$6.2 — 2007; \$5.7 — 2008; \$4.1 — 2009; \$2.0 — 2010; \$1.6 — 2011; and \$6.3 thereafter.

In connection with its ownership interests in certain affiliates, the Company had the following outstanding guarantees at December 31, 2006:

	<u>Amount</u> (in millions)	<u>Debt Included on</u> <u>Consolidated</u> <u>Balance Sheet</u> (in millions)
Consolidated companies guarantees — credit facilities	\$ 28.0	\$ 25.5
Other consolidated company guarantees — operating leases	4.7	—
Non-consolidated company guarantees	3.8	—
Total	<u>\$ 36.5</u>	<u>\$ 25.5</u>

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The Company has committed capital of approximately \$6.2 million, including a conditional commitment to provide a partner company with additional funding and commitments made to various private equity funds in prior years. These commitments will be funded over the next several years, including approximately \$4.9 million which is expected to be funded during the next twelve months.

Under certain circumstances, the Company may be required to return a portion or all the distributions it received as a general partner of certain private equity funds (the “clawback”). Assuming the private equity funds in which the Company was a general partner were liquidated or dissolved on December 31, 2006 and assuming for these purposes the only distributions from the funds were equal to the carrying value of the funds on the December 31, 2006 financial statements, the maximum clawback the Company would be required to return for our general partner interest is approximately \$8 million. The Company estimates its liability to be approximately \$6.7 million of which \$5.3 million was reflected in Accrued Expenses and Other Current Liabilities and \$1.4 million was reflected in Other Long-Term Liabilities on the Consolidated Balance Sheets.

The Company’s ownership in the funds which have potential clawback liabilities range 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.

In October 2001, the Company entered into an agreement with Mr. Musser, its former Chairman and Chief Executive Officer, to provide for annual payments of \$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 \$2.5 million was included in Other Long-Term Liabilities on the Consolidated Balance Sheet at December 31, 2006.

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, 2006.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**18. Parent Company Financial Information**

Parent company financial information is provided to present the financial position and results of operations of the Company as if the consolidated companies (see Note 1) were accounted for under the equity method of accounting for all periods presented during which the Company owned its interest in these companies.

*Parent Company Balance Sheets*

	As of December 31,	
	2006	2005
	(In thousands)	
<b>Assets:</b>		
Cash and cash equivalents	\$ 59,933	\$108,300
Restricted cash	—	1,098
Marketable securities	94,155	31,770
Restricted marketable securities	3,869	3,805
Other current assets	1,978	1,704
Asset held-for-sale	—	24,242
Total current assets	159,935	170,919
Ownership interests in and advances to companies	178,409	150,891
Long-term marketable securities	487	3,311
Long-term restricted marketable securities	5,737	9,457
Cash held in escrow	19,398	—
Other	3,377	5,109
Total Assets	<u>\$367,343</u>	<u>\$339,687</u>
<b>Liabilities and Shareholders' Equity:</b>		
Current convertible senior debentures	—	5,000
Current liabilities	18,816	13,625
Total current liabilities	18,816	18,625
Long-term liabilities	5,625	11,087
Convertible senior debentures	129,000	145,000
Shareholders' equity	213,902	164,975
Total Liabilities and Shareholders' Equity	<u>\$367,343</u>	<u>\$339,687</u>

*Parent Company Statements of Operations*

	Year Ended December 31,		
	2006	2005	2004
	(In thousands)		
Operating expenses	\$(24,346)	\$(18,063)	\$(19,293)
Other income, net	5,441	6,343	38,659
Recovery (impairment) — related party	360	28	(3,400)
Interest income	6,703	4,871	2,409
Interest expense	(4,617)	(4,914)	(8,647)
Equity loss	(28,605)	(26,373)	(35,069)
Net loss from continuing operations before income taxes	(45,064)	(38,108)	(25,341)
Income tax benefit	1,284	—	—
Equity income (loss) attributable to discontinued operations	89,810	6,038	(29,479)
Net income (loss)	<u>\$ 46,030</u>	<u>\$(32,070)</u>	<u>\$(54,820)</u>

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

*Parent Company Statements of Cash Flows*

	Year Ended December 31,		
	2006	2005 (In thousands)	2004
<b>Cash Flows from Operating Activities:</b>			
Net income (loss)	\$ 46,030	\$ (32,070)	\$ (54,820)
Adjustments to reconcile to net cash used in operating activities:			
(Income) loss from discontinued operations	(89,810)	(5,094)	19,819
Depreciation	197	183	203
Equity loss	28,605	25,404	44,729
Non-cash compensation charges	4,037	1,264	2,153
Other income, net	(5,441)	(6,343)	(38,659)
(Recovery) impairment — related party	(360)	(28)	3,400
Changes in assets and liabilities, net of effect of acquisitions and dispositions:			
Other current assets	—	1,111	(320)
Other current liabilities	4,703	2,039	(968)
Net cash provided by (used in) operating activities	<u>(12,039)</u>	<u>(13,534)</u>	<u>(24,463)</u>
<b>Cash Flows from Investing Activities</b>			
Proceeds from sales of available-for-sale and trading securities	3,551	241	14,784
Proceeds from sales of and distributions from companies and funds	1,530	29,467	39,085
Advances to companies	—	(3,898)	(615)
Acquisitions of ownership interests in companies and funds, net of cash acquired	(52,596)	(44,964)	(58,263)
Repayment of note receivable-related party, net	360	1,413	7,162
Increase in restricted cash and short-term investments	(208,514)	(55,602)	(42,160)
Decrease in restricted cash and short-term investments	146,129	57,387	16,143
Purchases of held-to-maturity securities	—	—	(16,715)
Capital expenditures	(101)	(44)	(272)
Other, net	72	—	1,068
Proceeds from sale of discontinued operations	93,410	—	125,853
Net cash provided by (used in) investing activities	<u>(16,159)</u>	<u>(16,000)</u>	<u>86,070</u>
<b>Cash Flows from Financing Activities:</b>			
Proceeds from convertible senior debentures	—	—	150,000
Payment of offering costs on convertible senior debentures	—	—	(4,887)
Repurchase of convertible senior debentures	(16,215)	—	—
Repurchase of convertible subordinated notes	—	—	(200,000)
Payment of costs to repurchase convertible subordinated notes	—	—	(1,368)
Decrease in restricted cash	1,098	—	—
Advance (to) from subsidiary	(5,500)	9,511	—
Issuance of Company common stock, net	448	61	1,392
Net cash provided by (used in) financing activities	<u>(20,169)</u>	<u>9,572</u>	<u>(54,863)</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(48,367)</b>	<b>(19,962)</b>	<b>6,744</b>
Cash and Cash Equivalents at beginning of period	<u>108,300</u>	<u>128,262</u>	<u>121,518</u>
<b>Cash and Cash Equivalents at end of period</b>	<b><u>\$ 59,933</u></b>	<b><u>\$108,300</u></b>	<b><u>\$ 128,262</u></b>

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

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**19. Supplemental Cash Flow Information**

During the years ended December 31, 2006, 2005 and 2004, the Company converted \$0.2 million, \$2.3 million and \$1.2 million, respectively, of advances to companies into ownership interests in companies.

Interest paid in 2006, 2005 and 2004 was \$6.7 million, \$6.5 million and \$9.2 million, respectively, of which \$3.7 million in 2006, \$3.9 million in 2005 and \$7.6 million in 2004 was related to the Company's convertible subordinated notes and senior debentures.

Cash paid for taxes in the years ended December 31, 2006, 2005 and 2004 was \$0.3 million, \$0.2 million and \$0.2 million, respectively.

During the years ended December 31, 2006 and 2005, the Company received distributions from a private equity fund of 68,026, and 37,658 common shares of Arbinet-the-exchange ("Arbinet"), valued at \$0.5 million and \$0.5 million on the date of distribution, respectively. The Arbinet shares were sold during 2006 and 2005 for net cash proceeds of \$0.3 million and \$0.2 million, respectively. During the year ended December 31, 2004, the Company sold its interest in Sanchez for \$32.1 million in cash and 226,435 shares of FNF common stock valued at \$8.3 million on the date of the merger. The FNF shares were sold during 2004 for net cash proceeds of \$8.3 million. Also during 2004, the Company sold its interest in Tangram Enterprise Solutions for shares of Opsware, Inc. valued at \$6.9 million. The Opsware shares were sold during 2004 for \$6.5 million in net cash proceeds.

**20. Operating Segments**

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

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

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

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

Segment assets in Other Items included primarily cash, cash equivalents and marketable securities of \$154.1 million and \$141.2 million at December 31, 2006 and 2005 respectively.

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

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

As of December 31, 2006 and 2005, the Company's assets were primarily located in the United States.

The following represents the segment data from continuing operations:

	<b>For the Year Ended December 31, 2006</b> (in thousands)								
	Acsis	Alliance Consulting	Clariant	Laureate Pharma	Pacific Title	Other Companies	Total Segments	Other Items	Total Continuing Operations
Revenue	\$18,634	\$104,571	\$ 33,605	\$11,714	\$29,536	\$ —	\$198,060	\$ —	\$198,060
Operating income (loss)	(8,776)	808	(15,607)	(9,129)	2,368	—	(30,336)	(24,346)	(54,682)
Net income (loss) from continuing operations	(8,264)	127	(9,587)	(9,737)	2,384	(2,455)	(27,532)	(16,248)	(43,780)
<b>Segment Assets:</b>									
December 31, 2006	\$27,266	\$ 83,766	\$ 42,652	\$25,626	\$20,589	\$55,035	\$254,934	\$188,447	\$443,381
December 31, 2005	30,993	80,959	40,599	21,479	18,864	21,208	214,102	161,242	375,344

	<b>For the Year Ended December 31, 2005</b> (in thousands)								
	Acsis	Alliance Consulting	Clariant	Laureate Pharma	Pacific Title	Other Companies	Total Segments	Other Items	Total Continuing Operations
Revenue	\$ 2,022	\$82,604	\$ 20,150	\$ 7,709	\$31,346	\$ —	\$143,831	\$ —	\$143,831
Operating income (loss)	(2,579)	(422)	(15,981)	(10,471)	3,644	—	(25,809)	(18,063)	(43,872)
Net income (loss) from continuing operations	(2,556)	(1,194)	(9,717)	(10,870)	3,748	(791)	(21,380)	(16,728)	(38,108)

	<b>For the Year Ended December 31, 2004</b> (in thousands)								
	Alliance Consulting	Clariant	Laureate Pharma	Pacific Title	Other Companies	Total Segments	Other Items	Total Continuing Operations	
Revenue	\$71,814	\$ 9,769	\$ 884	\$25,609	\$ 1,278	\$109,354	\$ —	\$109,354	
Operating income (loss)	(7,439)	(20,974)	(251)	1,226	(1,396)	(28,834)	(19,259)	(48,093)	
Net income (loss) from continuing operations	(7,736)	(12,829)	(270)	1,157	26,157	6,479	(31,820)	(25,341)	

**Other Items**

	<b>Year Ended December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
	(In thousands)		
Corporate operations	\$(17,271)	\$(16,811)	\$(31,940)
Income tax benefit (expense)	1,023	83	120
	<u>\$(16,248)</u>	<u>\$(16,728)</u>	<u>\$(31,820)</u>

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**21. Selected Quarterly Financial Information (Unaudited)**

	Three Months Ended			
	March 31	June 30	September 30	December 31
	(In thousands except per share data)			
<b>2006:</b>				
Revenue	\$ 46,100	\$ 48,010	\$ 50,608	\$ 53,342
Cost of sales	34,025	34,643	35,829	37,893
Selling, general and administrative	24,006	24,819	24,599	26,538
Research and development	1,750	1,622	1,660	1,945
Amortization of intangibles	973	972	700	768
Total operating expenses	<u>60,754</u>	<u>62,056</u>	<u>62,788</u>	<u>67,144</u>
Operating loss	(14,654)	(14,046)	(12,180)	(13,802)
Other income (loss), net	3,137	(1,243)	3,077	602
Recovery (impairment) — related party	—	—	—	360
Interest income	1,543	1,576	1,399	2,396
Interest expense	(1,618)	(1,659)	(1,777)	(1,767)
Equity income (loss)	(605)	335	(1,910)	(1,087)
Minority interest	1,997	1,895	1,789	1,439
Net loss from continuing operations before income taxes	(10,200)	(13,142)	(9,602)	(11,859)
Income tax (expense) benefit	(12)	1,235	(83)	(117)
Net loss from continuing operations	(10,212)	(11,907)	(9,685)	(11,976)
Income from discontinued operations, net of tax	3,760	2,672	78	83,300
	<u>\$ (6,452)</u>	<u>\$ (9,235)</u>	<u>\$ (9,607)</u>	<u>\$ 71,324</u>
Basic income (loss) per share (a)				
Net loss from continuing operations	\$ (0.08)	\$ (0.10)	\$ (0.08)	\$ (0.10)
Net income from discontinued operations	0.03	0.02	—	0.69
	<u>\$ (0.05)</u>	<u>\$ (0.08)</u>	<u>\$ (0.08)</u>	<u>\$ 0.59</u>
Diluted income (loss) per share (a)				
Net loss from continuing operations	\$ (0.08)	\$ (0.10)	\$ (0.08)	\$ (0.10)
Net income from discontinued operations	0.03	0.02	—	0.69
	<u>\$ (0.05)</u>	<u>\$ (0.08)</u>	<u>\$ (0.08)</u>	<u>\$ 0.59</u>
<b>2005:</b>				
Revenue	\$ 31,965	\$ 37,145	\$ 34,033	\$ 40,688
Cost of sales	23,784	25,756	25,624	30,017
Selling, general and administrative	17,846	16,638	18,834	20,860
Research and development	887	759	921	1,227
Purchased in-process research and development	—	—	—	2,183
Amortization of intangibles	632	589	611	535
Total operating expenses	<u>43,149</u>	<u>43,742</u>	<u>45,990</u>	<u>54,822</u>
Operating loss	(11,184)	(6,597)	(11,957)	(14,134)
Other income (loss), net	(9)	1,259	966	5,122
Recovery (impairment) — related party	(158)	(102)	—	288
Interest income	1,119	1,132	1,363	1,370
Interest expense	(1,491)	(1,549)	(1,659)	(1,729)
Equity loss	(4,031)	(1,376)	(599)	(591)
Minority interest	1,636	1,215	1,849	1,656
Net loss from continuing operations before income taxes	(14,118)	(6,018)	(10,037)	(8,018)
Income tax (expense) benefit	176	(136)	(38)	81
Net loss from continuing operations	(13,942)	(6,154)	(10,075)	(7,937)
Income (loss) from discontinued operations, net of tax	(2,151)	(1,525)	(565)	10,279
	<u>\$ (16,093)</u>	<u>\$ (7,679)</u>	<u>\$ (10,640)</u>	<u>\$ 2,342</u>
Basic income (loss) per share (a)				
Net loss from continuing operations	\$ (0.12)	\$ (0.05)	\$ (0.08)	\$ (0.07)
Net income (loss) from discontinued operations	(0.01)	(0.01)	(0.01)	0.09
	<u>\$ (0.13)</u>	<u>\$ (0.06)</u>	<u>\$ (0.09)</u>	<u>\$ 0.02</u>
Diluted income (loss) per share (a)				
Net loss from continuing operations	\$ (0.12)	\$ (0.05)	(0.08)	\$ (0.07)
Net income (loss) from discontinued operations	(0.01)	(0.01)	(0.01)	0.09

\$ (0.13)

\$ (0.06)

\$ (0.09)

\$ 0.02

**SAFEGUARD SCIENTIFICS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

- (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.

## 22. Trade Accounts Receivable

The following table summarizes the activity in the allowance for doubtful accounts:

	(In thousands)
Balance, December 31, 2003	\$ 1,016
Charged to costs and expenses	643
Charge-offs	(309)
Other	(272)
Balance, December 31, 2004	1,078
Charged to costs and expenses	1,612
Charge-offs	(1,220)
Other	250
Balance, December 31, 2005	1,720
Charged to costs and expenses	942
Charge-offs	(869)
Balance, December 31, 2006	\$ 1,793

## 23. Subsequent Events

On March 8, 2007, Clariant sold its technology group business (which developed, manufactured and marketed the ACIS Automated Image Analysis System) and related intellectual property to Zeiss MicroImaging, Inc. (the “ACIS Sale”) for an aggregate purchase price of \$12.5 million (including \$1.5 million in contingent purchase price). As part of the ACIS Sale, Clariant entered into a license agreement with Zeiss pursuant to which Zeiss granted Clariant a non-exclusive, perpetual and royalty-free license to certain of the intellectual property for use in connection with imaging applications and Clariant’s laboratory services business. Clariant and Zeiss also committed to pursue strategic joint development arrangements to develop novel markers and new menu applications for the ACIS product line.

On March 7, 2007, the Company provided a subordinated revolving credit line (the “Mezzanine Facility”) to Clariant. Under the Mezzanine Facility, which expires December 8, 2008, the Company committed to provide Clariant access to up to \$6 million in working capital funding. Amounts funded under the Mezzanine Facility will earn interest at an annual rate of 12%. The Mezzanine Facility was originally \$12 million, but was reduced by \$6 million as a result of the ACIS Sale. In connection with the Mezzanine Facility, Clariant issued to the Company warrants to purchase Clariant common stock and will issue additional warrants depending on amounts borrowed under the Mezzanine Facility.

**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

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

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

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

Our management's report on internal control over financial reporting is set forth in Item 8 of this annual report on Form 10-K and is incorporated by reference herein.

(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 portions of the Definitive Proxy Statement entitled “Election of Directors,” “Corporate Governance Principles and Board Matters” and “Section 16(a) Beneficial Ownership Reporting Compliance.” Information about our executive officers is included as an Annex to Part I above.

**Item 11. *Executive Compensation***

Incorporated by reference to the portions of the Definitive Proxy Statement entitled “Compensation Discussion and Analysis,” “Compensation Committee Report,” “Compensation Committee Interlocks and Insider Participation,” and “Executive Compensation.”

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

Incorporated by reference to the portion of the Definitive Proxy Statement entitled “Stock Ownership of 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 stock options for their service on our Board and Advisory Boards, respectively. Members of our Board also 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.

Our Board is authorized to administer our equity compensation plans, adopt, amend and repeal the administrative rules relating to the plans, and interpret the provisions of the plans. Our Board has delegated to the Compensation Committee of the Board (the “Compensation Committee”) authority to administer our equity compensation plans.

Our Compensation Committee has the authority to select the recipients of grants under our equity compensation plans and determine the terms and conditions of the grants, including but not limited to (i) the number of shares of common stock covered by such grants, (ii) the type of grant, (iii) the dates upon which such grants vest (which for time-based vesting options is typically 25% on the first anniversary of the grant date and in 36 equal monthly installments thereafter) and for market-based vesting options is based upon the achievement of improvement in Safeguard’s market capitalization above the base market capitalization established at the time of grant), (iv) the exercise price of options (which is equal to the average of the high and low prices of a share of our common stock as reported on the New York Stock Exchange consolidated tape on the grant date) or the consideration to be paid in connection with restricted stock, stock units or other stock-based grants (which may be no consideration), and (v) the term of the grant. Deferred stock units issued to directors are payable, on a one-for-one basis, in shares of Safeguard common stock following a director’s termination of service on the Safeguard Board.

The 2001 Plan provides 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 can be made under this plan to executive officers and 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. This plan is administered by the Compensation Committee which, as described above, has the authority to issue equity grants under the 2001 Plan and to establish the terms and conditions of such grants. 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).

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A total of 5,400,000 shares of our common stock are authorized for issuance under the 2001 Plan. At December 31, 2006, 3,764,031 shares were subject to outstanding options, 99,389 shares were available for future issuance, and 1,536,580 shares had been issued under the 2001 Plan. If any option granted under the 2001 Plan expires or is terminated, surrendered, canceled or forfeited, or if any shares of restricted stock, performance units or other stock-based grants are forfeited, the unused shares of common stock covered by such grants will again be available for grant under the 2001 Plan.

Our Board is authorized to make appropriate adjustments in connection with the 2001 Plan to reflect any stock split, stock dividend, recapitalization, liquidation, spin-off or other similar event. The 2001 Plan also contains provisions addressing the consequences of any Reorganization Event or Change in Control (as such terms are defined in the 2001 Plan). If a Reorganization or Change of Control Event occurs, unless the Compensation Committee determines otherwise, all outstanding options and stock appreciation rights (SARs) that are not exercised will be assumed by, or replaced with comparable options or rights by, the surviving corporation (or a parent of the surviving corporation), and other outstanding grants will be converted to similar grants of the surviving corporation or a parent of the surviving corporation). Notwithstanding that provision, the Compensation Committee has the authority to take one or both of the following actions: (i) require that grantees surrender their outstanding options and SARs in exchange for a payment by Safeguard in cash or company stock, as determined by the Compensation Committee, in an amount equal to the amount by which the then fair market value of the shares of stock subject to the unexercised options and SARs exceeds the exercise price of the options or the base amount of the SARs, as applicable, or (ii) after giving grantees an opportunity to exercise their outstanding options and SARs or otherwise realize the value of all of their other grants, terminate any or all unexercised options, SARs and grants at such time as the Compensation Committee deems appropriate.

During 2005, the Safeguard Board's Compensation Committee granted "employee inducement" awards to two newly hired executive officers. The awards were granted outside of Safeguard's existing equity compensation plans under NYSE rules and consisted of options to purchase up to an aggregate of 6,000,000 shares of Safeguard common stock. The awards have an eight-year term and a per share exercise price equal to the average of the high and low prices of Safeguard common stock on the respective executive's employment commencement date. Of the shares underlying the options, an aggregate of 375,000 shares vested on the first anniversary of the grant date, 1,125,000 shares vest in 36 equal monthly installments thereafter and the remaining 4,500,000 shares vest incrementally based upon the achievement of certain specified levels of improvement in Safeguard's market capitalization. With the exception of the market-based vesting provisions, the terms and provisions of the employee inducement awards are substantially the same as options previously awarded to other executives under Safeguard's equity compensation plans.

## Table of Contents

The following table provides information as of December 31, 2006 about the securities authorized for issuance under our equity compensation plans.

### Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights <sup>(1)</sup>	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
	Equity compensation plans approved by security holders <sup>(2)</sup>	10,235,012	\$2.2238
Equity compensation plans not approved by security holders <sup>(3)</sup>	<u>9,764,031</u>	\$1.7562	<u>99,389</u>
Total	<u>19,999,043</u>	\$1.9800	<u>3,359,175</u>

(1) The weighted average exercise price calculation excludes 1,271,127 shares underlying outstanding deferred stock units awarded to executive officers and directors included in column (a) which are payable in stock, on a one-for-one basis.

(2) Represents awards granted, and shares available for issuance, under the 1999 Equity Compensation Plan and the 2004 Equity Compensation Plan. Includes 1,135,145 shares underlying deferred stock units awarded to executive officers and directors for no consideration and 135,982 shares underlying deferred stock units awarded to directors in lieu of all or a portion of directors' fees. Payments in respect of deferred stock units are generally distributable following termination of employment or service, death, permanent disability or retirement. The value of the deferred stock units was approximately \$3.8 million based on the fair value of the stock on the various grant dates. The deferred stock units generally vest over a period of four years, with the exception of deferred stock units issued to directors in lieu of compensation, which are fully vested, and matching deferred stock units awarded to directors, which vest on the first anniversary of the grant.

(3) Includes awards granted and shares available for issuance under the 2001 Plan and 6,000,000 "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."

## 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.

**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	Agreement and Plan of Merger dated as of November 9, 2005 by and among Safeguard Delaware, Inc., Safeguard Scientifics, Inc., AI Acquisition Corporation, Acsis, Inc., certain stockholders of Acsis, Inc., and Wand Equity Portfolio II LP	Form 8-K 11/10/05	99.1
2.2	Agreement and Plan of Merger, dated as of August 14, 2006, among Safeguard Scientifics, Inc., Safeguard Delaware, Inc., Safeguard 2001 Capital, L.P., SRA Ventures, LLC, SRA International, Inc., Systems Research and Application Corporation, Mantas, Inc., i-flex solutions, ltd., i-flex America, inc. and Mandarin Acquisition Corp.	Form 8-K 8/15/06	99.2
3.1	Amended and Restated Articles of Incorporation of Safeguard	Form 10-K 3/15/04	3.1
3.2	By-laws of Safeguard, as amended	Form 10-Q 5/15/01	3.1
4.1	Rights Agreement dated as of March 1, 2000 between Safeguard Scientifics, Inc. and ChaseMellon Shareholder Services LLC, as Rights Agent	Form 8-K 2/29/00	4
4.2	Designation of Series A Junior Participating Preferred Shares	Form 10-K 3/22/00	4.11
4.3	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
10.1.1 *	Safeguard Scientifics, Inc. 1999 Equity Compensation Plan, as amended	Form 10-K 4/2/01	4.3
10.1.2 *	Amendment No. 1 to the Safeguard Scientifics, Inc. 1999 Equity Compensation Plan	Form 10-Q 8/6/04	10.2
10.2.1	Safeguard Scientifics, Inc. 2001 Associates Equity Compensation Plan	Form S-8 11/14/01	4.1

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Exhibit Number	Description	Incorporated Filing Reference	
		Form Type & Filing Date	Original Exhibit Number
10.2.2	Amendment No. 1 to the Safeguard Scientifics, Inc. 2001 Associates Equity Compensation Plan	Form 10-K 3/21/03	4.4.1
10.2.3	Amendment No. 2 to the Safeguard Scientifics, Inc. 2001 Associates Equity Compensation Plan	Form 10-Q 8/6/04	10.3
10.3 *	Safeguard Scientifics, Inc. 2004 Equity Compensation Plan	Form 10-Q 8/6/04	10.1
10.4 *	Stock Option Grant Certificate issued to Peter J. Boni dated August 16, 2005	Form 10-Q 11/9/05	10.2
10.5 *	Stock Option Grant Certificate issued to James A. Datin dated September 7, 2005	Form 10-Q 11/9/05	10.4
10.6 *	Stock Option Grant Certificate issued to John A. Loftus dated September 13, 2005	Form 8-K 9/19/05	99.1
10.7.1*	Stock Option Grant Certificate issued to Christopher J. Davis dated October 25, 2005	Form 8-K 10/31/05	99.1
10.7.2 *	Stock Option Grant Certificate issued to Christopher J. Davis dated December 16, 2005	Form 8-K 12/21/05	99.1
10.8 *	Stock Option Grant Certificate issued to Steven J. Feder dated October 25, 2005	Form 8-K 10/31/05	99.2
10.9 *†	Stock Option Grant Certificate issued to Stephen Zarrilli dated December 15, 2006	—	—
10.10 *†	Restricted Stock Grant Agreement issued to John A. Loftus dated December 15, 2006	—	—
10.11.1 *	Form of directors' stock option grant certificate (prior to February 21, 2007)	Form 10-Q 11/9/04	10.3
10.11.2 *†	Form of directors' stock option grant certificate as of February 21, 2007	—	—
10.12 *	Form of officers' stock option grant certificate	Form 10-Q 11/9/04	10.4
10.13 *	Safeguard Scientifics, Inc. Group Stock Unit Award Program—form of grant document	Form 10-Q 11/9/04	10.5
10.14 *	Safeguard Scientifics, Inc. Group Stock Unit Program for Directors—form of grant document	Form 10-Q 11/9/04	10.6
10.15 *	Form of Restricted Stock Grant Agreement	Form 10-Q 11/9/04	10.7
10.16 *	Safeguard Scientifics, Inc. Long Term Incentive Plan, as amended and restated effective June 15, 1994	Form 10-K 3/30/95	10.6
10.17 *	Safeguard Scientifics, Inc. Executive Deferred Compensation Plan (amended and restated as of October 25, 2005)	Form 10-K 3/13/06	10.16
10.18 *	2006 Management Incentive Plan	Form 8-K 2/27/06	99.1
10.19 *†	Compensation Summary — Non-employee Directors	—	—
10.20 *	Employment Transition and Retirement Agreement between Safeguard Scientifics, Inc. and Anthony L. Craig dated April 13, 2005	Form 8-K 4/15/05	99.1

10.21.1 *	Employment Agreement dated August 17, 2004 between Safeguard Scientifics, Inc. and Christopher J. Davis	Form 10-Q 11/9/04	10.2
10.21.2 *†	Agreement dated December 14, 2006 between Safeguard Scientifics, Inc. and Christopher J. Davis	—	—

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Exhibit Number	Description	Incorporated Filing Reference	
		Form Type & Filing Date	Original Exhibit Number
10.22 *	Employment Letter, effective November 17, 2004, and Letter Agreement, dated November 17, 2004, by and between Safeguard Scientifics, Inc. and Steven J. Feder	Form 8-K 11/19/04	99.1
10.23 *	Letter Agreement dated February 25, 2005 by and between Safeguard Scientifics, Inc. and John A. Loftus	Form 8-K 2/25/05	99.1
10.24 *	Agreement by and between Safeguard Scientifics, Inc. and Peter J. Boni dated August 1, 2005	Form 8-K 8/4/05	99.1
10.25 *	Agreement by and between Safeguard Scientifics, Inc. and James A. Datin dated September 7, 2005	Form 8-K 9/13/05	99.1
10.26 *†	Agreement by and between Safeguard Scientifics, Inc. and Stephen Zarrilli dated as of December 15, 2006	—	—
10.27.1	Loan Agreement dated May 10, 2002 by and among Comerica Bank — California, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 10-Q 8/14/02	10.1
10.27.2	First Amendment dated May 9, 2003 to Loan Agreement dated May 10, 2002, by and among Comerica Bank — California, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 10-Q 5/13/03	10.1
10.27.3	Second Amendment dated February 12, 2004 to Loan Agreement dated May 10, 2002 by and among Comerica Bank — California, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 10-K 3/15/04	10.19
10.27.4	Third Amendment dated May 5, 2004 to Loan Agreement dated May 10, 2002 by and among Comerica Bank — California, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 10-Q 5/10/04	10.29
10.27.5	Fourth Amendment dated September 30, 2004 to Loan Agreement dated May 10, 2002 by and among Comerica Bank, successor by merger to Comerica Bank — California, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 8-K 10/5/04	10.1
10.27.6	Fifth Amendment dated as of May 2, 2005, to Loan Agreement dated as of May 10, 2002, as amended, by and among Comerica Bank, successor by merger to Comerica Bank — California, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 8-K 5/6/05	99.1
10.27.7	Sixth Amendment dated as of August 1, 2005, to Loan Agreement dated as of May 10, 2002, as amended, by and among Comerica Bank, successor by merger to Comerica Bank — California, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 8-K 8/4/05	99.4
10.27.8	Guaranty dated May 10, 2002 by Safeguard Scientifics, Inc. to Comerica Bank, successor by merger to Comerica Bank—California	Form 10-K 3/15/05	10.18.6
10.27.9	Affirmation and Amendment of Guaranty dated September 30, 2004, by Safeguard Scientifics, Inc. to Comerica Bank, successor by merger to Comerica Bank—California	Form 8-K 10/5/04	10.2

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Exhibit Number	Description	Incorporated Filing Reference	
		Form Type & Filing Date	Original Exhibit Number
10.27.10	Seventh Amendment dated as of May 4, 2006 to Loan Agreement dated as of May 10, 2002, as amended, by and between Comerica Bank, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 10-Q 8/4/06	10.1
10.27.11 †	Eighth Amendment dated as of February 28, 2007 to Loan Agreement dated as of May 10, 2002, as amended, by and between Comerica Bank, Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	—	—
10.28.1	Loan Agreement dated as of November 17, 2006 by and among Commerce Bank, N.A., Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	Form 8-K 11/20/06	99.1
10.28.2	Guaranty dated as of November 17, 2006 by Safeguard Scientifics, Inc. to Commerce Bank, N.A.	Form 8-K 11/20/06	99.2
10.29.1	Guaranty dated September 30, 2004 by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Alliance Consulting)	Form 8-K 10/5/04	10.4
10.29.2	Affirmation of Guaranty dated September 30, 2004 by Safeguard Scientifics, Inc.	Form 8-K 10/5/04	10.5
10.29.3	Amendment and Affirmation of Guaranty dated as of February 28, 2006 by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Alliance)	Form 8-K 3/6/06	99.7
10.29.4	Amendment and Affirmation of Guaranty dated as of February 28, 2006 by Safeguard Scientifics, Inc. (on behalf of Alliance)	Form 8-K 3/6/06	99.6
10.29.5 †	Amended and Restated Loan Agreement dated February 28, 2007 for \$15 million by and among Comerica Bank, Alliance Consulting Group Associates, Inc. and Alliance Holdings, Inc.	—	—
10.29.6 †	Amended and Restated Loan Agreement dated February 28, 2007 for \$5 million by and among Comerica Bank, Alliance Consulting Group Associates, Inc. and Alliance Holdings, Inc.	—	—
10.29.7 †	Affirmation of Guaranty dated February 28, 2007 by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Alliance Consulting)	—	—
10.30.1	Loan Agreement dated March 11, 2005, by and between Comerica Bank—California and ChromaVision Medical Systems, Inc.	(1)	10.10
10.30.2	First Amendment dated October 21, 2003 to Loan and Security Agreement dated February 13, 2003 between ChromaVision Medical Systems, Inc. and Comerica Bank	(2)	10.4
10.30.3	Second Amendment dated January 22, 2004 to Loan and Security Agreement dated February 13, 2003 between ChromaVision Medical Systems, Inc. and Comerica Bank	(3)	10.6
10.30.4	Third Amendment dated as of January 31, 2005 to Loan Agreement dated February 13, 2003 by and between Comerica Bank and ChromaVision Medical Systems, Inc.	Form 8-K 2/3/05	99.2
10.30.5	Fourth Amendment dated as of March 11, 2005 to Loan Agreement dated February 13, 2003 by and between Comerica Bank and ChromaVision Medical Systems, Inc.	(3)	10.8

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Exhibit Number	Description	Incorporated Filing Reference	
		Form Type & Filing Date	Original Exhibit Number
10.30.6	Amended and Restated Unconditional Guaranty dated March 11, 2005 to Comerica Bank provided by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of ChromaVision)	(3)	10.9
10.30.7	Reimbursement and Indemnity Agreement dated as of March 11, 2005 by ChromaVision Medical Systems, Inc. in favor of Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	(3)	10.10
10.30.8	Waiver and Fifth Amendment dated as of August 1, 2005 to Loan Agreement dated February 13, 2003 by and between Comerica Bank and Clariant, Inc.	(4)	99.1
10.30.9	Second Amended and Restated Unconditional Guaranty dated August 1, 2005 to Comerica Bank provided by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Clariant, Inc.)	(4)	99.2
10.30.10	Reimbursement and Indemnity Agreement dated as of August 1, 2005 by Clariant, Inc. in favor of Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.	(4)	99.3
10.30.11	Sixth Amendment dated as of February 28, 2006, to Loan Agreement dated as of February 13, 2003, as amended, by and between Comerica Bank and Clariant, Inc., formerly known as ChromaVision Medical Systems, Inc.	Form 8-K 3/6/06	99.3
10.31.1	Loan and Security Agreement dated as of December 1, 2004 by and between Comerica Bank and Laureate Pharma, Inc.	Form 8-K 12/7/04	99.1
10.31.2	Guaranty dated December 1, 2004 to Comerica Bank provided by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Laureate Pharma)	Form 8-K 12/7/04	99.2
10.31.3	First Amendment dated as of January 31, 2005 to Loan and Security Agreement dated as of December 1, 2004 by and between Comerica Bank and Laureate Pharma, Inc.	Form 8-K 2/3/05	99.3
10.31.4	Second Amendment dated as of May 5, 2005 to Loan and Security Agreement dated as of December 1, 2004 by and between Comerica Bank and Laureate Pharma, Inc.	Form 10-Q 8/8/05	10.4
10.31.5	Third Amendment dated as of June 20, 2005 to Loan and Security Agreement dated as of December 1, 2004 by and between Comerica Bank and Laureate Pharma, Inc.	Form 10-Q 8/8/05	10.5
10.31.6	Affirmation and Amendment of Guaranty dated June 20, 2005 to Comerica Bank provided by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Laureate Pharma)	Form 10-Q 8/8/05	10.6
10.31.7	Fourth Amendment dated as of February 28, 2006 to Loan and Security Agreement dated as of December 1, 2004, by and between Comerica Bank and Laureate Pharma, Inc.	Form 8-K 3/6/06	99.4
10.31.8	Fifth Amendment dated as of August 2, 2006 to Loan and Security Agreement dated as of December 1, 2004, by and between Comerica Bank and Laureate Pharma, Inc.	Form 10-Q 11/3/06	10.2
10.31.9 †	Sixth Amendment dated as of February 28, 2007 to Loan and Security Agreement dated as of December 1, 2004, by and between Comerica Bank and Laureate Pharma, Inc.	—	—

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Exhibit Number	Description	Incorporated Filing Reference	
		Form Type & Filing Date	Original Exhibit Number
10.31.10 †	Amendment and Affirmation of Guaranty dated February 28, 2007 to Comerica Bank provided by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Laureate Pharma)	—	—
10.31.11 †	Deficiency Guaranty dated February 28, 2007 to Comerica Bank provided by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc. (on behalf of Laureate Pharma)	—	—
10.32.1	Securities Purchase Agreement dated November 8, 2005 by and among Clariant, Inc. and the investors named therein	(5)	99.1
10.32.2	Registration Rights Agreement dated November 8, 2005 by and among Clariant, Inc. and the investors named therein	(5)	99.2
10.32.3	Form of Common Stock Purchase Warrant issued by Clariant, Inc. pursuant to the Securities Purchase Agreement dated November 8, 2005	(5)	99.3
10.33	Letter of Credit issued to W.P. Carey	Form 8-K 10/5/04	10.1
10.34	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
14 †	Code of Business Conduct and Ethics	—	—
21 †	List of Subsidiaries	—	—
23.1 †	Consent of Independent Registered Public Accounting Firm — KPMG 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.	—	—

† 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.

- (1) Incorporated by reference to the Annual Report on Form 10-K filed March 31, 2003 by Clariant, Inc. (SEC File No. 000-22677)
- (2) Incorporated by reference to the Quarterly Report on Form 10-Q filed on November 14, 2003 by Clariant, Inc. (SEC File No. 000-22677)
- (3) Incorporated by reference to the Annual Report on Form 10-K filed March 14, 2005 by Clariant, Inc. (SEC File No. 000-22677)

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- (4) Incorporated by reference to the Current Report on Form 8-K filed on August 4, 2005 by Clariant, Inc. (SEC File No. 000-22677)
- (5) Incorporated by reference to the Current Report on Form 8-K filed on November 9, 2005 by Clariant, Inc. (SEC File No. 000-22677)

**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 27, 2007

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.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>PETER J. BONI</u> Peter J. Boni	President and Chief Executive Officer and Director (Principal Executive Officer)	Dated: March 27, 2007
<u>STEPHEN T. ZARRILLI</u> Stephen T. Zarrilli	Acting Senior Vice President, Acting Chief Administrative Officer and Acting Chief Financial Officer (Principal Financial and Accounting Officer)	Dated: March 27, 2007
<u>MICHAEL J. CODY</u> Michael J. Cody	Director	Dated: March 27, 2007
<u>JULIE A. DOBSON</u> Julie A. Dobson	Director	Dated: March 27, 2007
<u>ROBERT E. KEITH, JR.</u> Robert E. Keith, Jr.	Chairman of the Board of Directors	Dated: March 27, 2007
<u>ANDREW E. LIETZ</u> Andrew E. Lietz	Director	Dated: March 27, 2007
<u>GEORGE MACKENZIE</u> George MacKenzie	Director	Dated: March 27, 2007
<u>GEORGE MCCLELLAND</u> George McClelland	Director	Dated: March 27, 2007
<u>JACK L. MESSMAN</u> Jack L. Messman	Director	Dated: March 27, 2007
<u>JOHN W. PODUSKA, SR.</u> John W. Poduska Sr.	Director	Dated: March 27, 2007
<u>JOHN J. ROBERTS</u> John J. Roberts	Director	Dated: March 27, 2007





Safeguard Scientifics, Inc., a Pennsylvania corporation (the "Company"), hereby grants to the grantee named below ("Grantee") an option (this "Option") to purchase the total number of shares shown below of Common Stock of the Company (the "Shares") at the exercise price per share set forth below, subject to all of the terms and conditions on the reverse side of this Stock Option Grant Certificate and the 2004 Equity Compensation Plan (the "Plan"). Unless otherwise defined herein, capitalized terms used herein shall have the meanings ascribed to them in the Plan. The terms and conditions set forth on the reverse side hereof and the terms and conditions of the Plan are incorporated herein by reference. This Stock Option Grant Certificate shall constitute the "Agreement" for this Option as such term is used in the Plan.

Grant Date:	December 15, 2006
Stock Option	Nonqualified
Shares Subject to Option:	150,000
Exercise Price Per Share:	\$ 2.335
Term of Option:	8 years

Shares subject to issuance under this Option will vest and become exercisable in accordance with the provisions of the Agreement between Grantee and the Company dated as of December 15, 2006 ("Consulting Agreement") as follows, provided that in no event shall the number of stock options that may vest exceed 150,000:

- (i) Upon the timely and complete filing of the Company's Form 10-K for the year ending December 31, 2006 ("Form 10-K") with the SEC during the term of the Consulting Agreement, the product of (x) 15,000 times (y) the number of completed calendar months elapsed from December 15, 2006 through the date of such filing;
- (ii) Following the timely and complete filing of the Form 10-K, an additional 15,000 stock options shall vest on the first date of each calendar month beginning after such filing, provided that Grantee continues to provide services under the Consulting Agreement on each such date; and
- (iii) Upon the satisfactory completion of Grantee's services relating to the transition of his duties and responsibilities to his successor, as determined by the Company's Chief Executive Officer in his sole discretion, or upon Grantee's appointment as the Company's Chief Financial Officer (and the removal of the term "Acting" from his titles), all stock options that have not previously vested and become exercisable shall become fully vested and exercisable.

The Company shall have the right, without the consent of Grantee, to amend the terms of this Stock Option Grant Certificate to the extent necessary or appropriate, as determined by the Company in its sole discretion, to conform to Section 409A of the Internal Revenue Code of 1986, as amended.

Grantee hereby acknowledges receipt of a copy of the Plan, represents that Grantee has read the Plan and understands the terms and provisions of the Plan, and accepts this Option subject to all the terms and conditions of the Plan and this Stock Option Grant Certificate. Grantee acknowledges that the grant and exercise of this Option, and the sale of Shares obtained through the exercise of this Option, may have tax implications that could result in adverse tax consequences to the Grantee and that Grantee is not relying on the Company for any tax, financial or legal advice and will consult a tax adviser prior to such exercise or disposition.

This Option is designated a nonqualified stock option. It is not an incentive stock option within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code").

In witness whereof, this Stock Option Grant Certificate has been executed by the Company by a duly authorized officer as of the date specified hereon.

Safeguard Scientifics, Inc.

/s/ Peter J. Boni

\_\_\_\_\_  
Peter J. Boni, President and Chief Executive Officer

/s/ Stephen Zarrilli

\_\_\_\_\_  
Stephen Zarrilli

1. Option Expiration. All stock options that vest pursuant to this Agreement shall continue to be exercisable, subject to the terms and conditions of the Plan and this Agreement, until the earlier of (a) the eighth anniversary of the grant date and (b) the third anniversary of the cessation or termination of Grantee's services as the Company's Acting Chief Financial Officer or Chief Financial Officer. Any portion of the Option that is not vested at the time the Grantee ceases to provide services to the Company under the Consulting Agreement shall immediately terminate.

2. Exercise Procedures.

(a) Subject to the provisions of this Stock Option Grant Certificate and the Plan, the Grantee may exercise part or all of the vested Option by giving the Company written notice of intent to exercise in the manner provided in Paragraph 11 below, specifying the number of Shares as to which the Option is to be exercised. On the delivery date, the Grantee shall pay the exercise price (i) in cash, (ii) by delivering Shares of the Company (duly endorsed for transfer or accompanied by stock powers signed in blank) which shall be valued at their fair market value on the date of delivery, or (iii) by such other method as the Committee may approve, including payment through a broker in accordance with procedures permitted by Regulation T of the Federal Reserve Board. The Committee may impose from time to time such limitations as it deems appropriate on the use of Shares of the Company to exercise the Option.

(b) The obligation of the Company to deliver Shares upon exercise of the Option shall be subject to all applicable laws, rules, and regulations and such approvals by governmental agencies as may be deemed appropriate by the Committee, including such actions as Company counsel shall deem necessary or appropriate to comply with relevant securities laws and regulations. The Company may require that the Grantee (or other person exercising the Option after the Grantee's death) represent that the Grantee is purchasing Shares for the Grantee's own account and not with a view to or for sale in connection with any distribution of the Shares, or such other representation as the Board deems appropriate. All obligations of the Company under this Stock Option Grant Certificate shall be subject to the rights of the Company as set forth in the Plan to withhold amounts required to be withheld for any taxes, if applicable. Subject to Committee approval, the Grantee may elect to satisfy any income tax withholding obligation of the Company with respect to the Option by having Shares withheld up to an amount that does not exceed the minimum marginal tax rate for federal (including FICA), state and local tax liabilities.

3. Change of Control. The provisions of the Plan applicable to a Change of Control shall apply to the Option, and, in the event of a Change of Control, the Board may take such actions as it deems appropriate pursuant to the Plan.

4. Restrictions on Exercise. Only the Grantee may exercise the Option during the Grantee's lifetime. After the Grantee's death, the Option shall be exercisable (subject to the limitations specified in the Plan) solely by the legal representatives of the Grantee, or by the person who acquires the right to exercise the Option by will or by the laws of descent and distribution, to the extent that the Option is exercisable pursuant to this Stock Option Grant Certificate. Notwithstanding the foregoing, the Committee may provide, at or after grant, that a Grantee may transfer nonqualified stock options pursuant to a domestic relations order or to family members or other persons or entities on such terms as the Committee may determine.

5. Grant Subject to Plan Provisions. This grant is made pursuant to the Plan, the terms of which are incorporated herein by reference, and in all respects shall be interpreted in accordance with the Plan. The grant and exercise of the Option are subject to the provisions of the Plan and to interpretations, regulations and determinations concerning the Plan established from time to time by the Committee in accordance with the provisions of the Plan, including, but not limited to, provisions pertaining to (i) rights and obligations with respect to withholding taxes, (ii) the registration, qualification or listing of the Shares, (iii) capital or other changes of the Company, and (iv) other requirements of applicable law. The Committee shall have the authority to interpret and construe the Option pursuant to the terms of the Plan, and its decisions shall be conclusive as to any questions arising hereunder.

6. No Employment Rights. The grant of the Option shall not confer upon the Grantee any right to be retained by or in the employ of the Company and shall not interfere in any way with the right of the Company to terminate the Grantee's employment or service at any time. The right of the Company to terminate at will the Grantee's employment or service at any time for any reason is specifically reserved. No policies, procedures or statements of any nature by or on behalf of the Company (whether written or oral, and whether or not contained in any formal employee manual or handbook) shall be construed to modify this Grant Letter or to create express or implied obligations to the Grantee of any nature.

7. No Stockholder Rights. Neither the Grantee, nor any person entitled to exercise the Grantee's rights in the event of the Grantee's death, shall have any of the rights and privileges of a stockholder with respect to the Shares subject to the Option until certificates for Shares have been issued upon the exercise of the Option.

8. No Disclosure. The Grantee acknowledges that the Company has no duty to disclose to the Grantee any material information regarding the business of the Company or affecting the value of the Shares before or at the time of a termination of the Grantee's employment, including without limitation any plans regarding a public offering or merger involving the Company.

9. Assignment and Transfers. The rights and interests of the Grantee under this Stock Option Grant Certificate may not be sold, assigned, encumbered or otherwise transferred except, in the event of the death of the Grantee, by will or by the laws of descent and distribution. In the event of any attempt by the Grantee to alienate, assign, pledge, hypothecate, or otherwise dispose of the Option or any right hereunder, except as provided for in this Stock Option Grant Certificate, or in the event of the levy or any attachment, execution or similar process upon the rights or interests hereby conferred, the Company may terminate the Option by notice to the Grantee, and the Option and all rights hereunder shall thereupon become null and void. The rights and protections of the Company hereunder shall extend to any successors or assigns of the Company and to the Company's parents, subsidiaries, and affiliates. This Stock Option Grant Certificate may be assigned by the Company without the Grantee's consent.

10. Applicable Law. The validity, construction, interpretation and effect of this instrument shall be governed by and determined in accordance with the laws of the Commonwealth of Pennsylvania.

11. Notice. Any notice to the Company provided for in this instrument shall be addressed to the Company in care of the Chief Financial Officer at the Company's headquarters and any notice to the Grantee shall be addressed to such Grantee at the current address shown on the payroll of the Company, or to such other address as the Grantee may designate to the Company in writing. Any notice shall be delivered by hand, sent by telecopy or enclosed in a properly sealed envelope addressed as stated above, registered and deposited, postage prepaid, in a post office regularly maintained by the United States Postal Service.



**SAFEGUARD SCIENTIFICS, INC.  
RESTRICTED STOCK GRANT TERMS  
DATE OF GRANT: December 15, 2006**

Safeguard Scientifics, Inc. (the "Company") adopted the 1999 Equity Compensation Plan (the "Plan") to give participants an ownership interest in the Company and to create an incentive for participants to contribute to our growth, thereby benefiting our stockholders, and aligning the economic interests of the participants with those of our stockholders. This Restricted Stock Grant is granted to John A. Loftus (the "Grantee") this 15th day of December, 2006, in accordance with the terms of the Plan. Capitalized terms used and not otherwise defined in this Grant are used herein as defined in the Plan.

1. Stock Grant

The Company hereby offers to the Grantee the opportunity to acquire from the Company 42,827 shares of common stock of the Company, \$.10 par value (the "Shares"), for no consideration.

Subject to the Grantee's acceptance of this offer, the Company will issue the Shares in the name of the Grantee, which Shares shall be held in book entry at Mellon Investor Services, LLC, the Company's transfer agent, and shall be subject to restrictions on transfer as set forth in this Restricted Stock Grant.

2. Acceptance by the Grantee; Deposit of Certificates into Escrow

The Grantee shall signify acceptance of the offer to acquire the Shares by delivering to the Company, as escrow agent (the "Escrow Agent"):

- (i) a copy of the Acceptance of Grant which has been executed by the Grantee; and
- (ii) if, after consulting with his or her personal tax and financial advisor, the Grantee has determined that an 83b election should be made, two executed copies of an 83(b) Election (you may obtain the appropriate form from Dee Blackburn if you desire to make an 83(b) Election).

Upon receipt from the Grantee of the foregoing items, the Company shall cause Mellon Investor Services, LLC to issue the Shares in Grantee's name, in book entry, to be held in accordance with the terms of this Grant.

3. Vesting and Forfeiture of Unvested Shares

(a) In the event of Grantee's termination of employment for any reason other than as set forth in Section 3(b) below, Grantee shall forfeit all Shares in which Grantee is not vested at the time of his cessation of service in accordance with the Vesting Schedule set forth in Section 3(b) (hereinafter referred to as the "Unvested Shares").

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(b) Grantee shall acquire a vested interest in, and the forfeiture provisions of this paragraph shall lapse with respect to, the Shares as follows:

- One-third of the shares on December 15, 2007;
- One-third of the shares on December 15, 2008; and
- One-third of the shares on December 15, 2009;

provided, however, that in the event Grantee's employment terminates as a result of (i) death, (ii) permanent disability, (iii) retirement on or after his 65<sup>th</sup> birthday, or (iv) a Change of Control as set forth in his agreement with the Company dated February 25, 2005, the Grantee shall be deemed to be fully vested in any Unvested Shares.

#### 4. Restrictions

(a) Unvested Shares. All Unvested Shares will be held by the Escrow Agent until they become vested. Upon receipt of the taxes which the Company is required to withhold as set forth in Section 7 below, the Escrow Agent shall deliver to the Grantee the Share certificate registered in the Grantee's name for the Vested Shares. The Grantee may not sell, assign, transfer, pledge or otherwise dispose of any Unvested Shares until the scheduled Vesting Date and then only after all applicable withholding taxes have been paid by the Grantee.

(b) Impermissible Transfers Void. Any attempt to assign, transfer, pledge or otherwise dispose of any Shares contrary to the provisions of this Grant, and the levy of any execution, attachment or similar process upon any Unvested Shares, shall be null and void and without effect.

#### 5. Effect of Changes in Shares

If any change is made to the common stock of the Company by reason of merger, consolidation, reorganization, recapitalization, stock dividend, stock split, combination of shares, exchange of shares, or any other change in capital structure made without receipt of consideration, then any new, substituted, or additional securities distributed with respect to the Shares shall be immediately subject to the restrictions imposed upon the Shares to the same extent that the Shares immediately prior thereto have been covered by such provisions.

#### 6. Voting of Shares; Dividends

The Grantee shall be entitled to exercise all voting rights in connection with the Shares.

Effective as of the date on which the Grantee signifies acceptance of the Shares, the Grantee shall be entitled to receive any dividends, rights or other distributions payable to stockholders of record of the Company on and after the date of such acceptance; provided, however, that the Grantee shall not have any dividend rights or any other rights whatsoever with respect to any Shares which are forfeited in accordance with the terms of this Agreement.

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7. Withholding of Taxes

The Company shall have the right to require the Grantee to pay to the Company, in cash, the amount of any taxes which the Company is required to withhold in respect of this Grant or to take whatever action it deems necessary to protect the interests of the Company in respect of such tax liabilities, including, without limitation, withholding a portion of the Shares, selling for Grantee's account a portion of the Shares and applying the net proceeds thereof to the payment of such taxes, or deducting from other wages, bonuses or other amounts payable to the Grantee by the Company, any federal, state or local taxes required by law to be withheld with respect to such Grant.

8. No Contract for Employment

Nothing contained in this Grant shall be deemed to require the Company to continue the Grantee's employment. Except as may be provided in a written employment contract executed by a duly authorized officer of the Company, the Grantee shall at all times be an "employee-at-will" of the Company, and the Company may discharge the Grantee at any time for any reason, with or without cause.

9. Administration

This Grant is made pursuant to the terms, conditions and other provisions of the Plan as in effect on the Date of Grant, and as the Plan may be amended from time to time in accordance with the provisions of the Plan. All questions of interpretation and application of the Plan and of this Grant shall be determined by the Compensation Committee of the Company's Board of Directors, in its discretion, and any such determination shall be final and binding upon all persons. The validity, construction and effect of this Grant shall be determined in accordance with the laws of the Commonwealth of Pennsylvania, without giving effect to the principles of conflicts of law thereof.

SAFEGUARD SCIENTIFICS, INC.  
/s/ Steven J. Feder  
Steven J. Feder  
Senior Vice President & General Counsel

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## ACCEPTANCE OF GRANT

John A. Loftus (the "Grantee") acknowledges and agrees with the terms and conditions of the attached Grant Letter pursuant to which Safeguard Scientifics, Inc. (the "Company") has offered the Grantee the opportunity to acquire 42,827 shares of common stock of the Company, \$.10 par value (the "Shares").

As a condition to the issuance of the Shares, the Grantee hereby represents and warrants to the Company and agrees with the Company as follows:

1. Disposition of Shares. The Grantee hereby agrees not to sell, assign, transfer, pledge or otherwise dispose of any portion of the Shares unless and until the Grantee shall have complied with all of the requirements of the Grant.

2. Section 83(b) Election. The Grantee understands that under Section 83 of the Internal Revenue Code of 1986, as amended (the "Code"), the difference between the purchase price (if any) paid for the Shares and their fair market value on the date of vesting would be reportable as ordinary income at such time. The Grantee understands that by filing an election with the Internal Revenue Service pursuant to Section 83(b) of the Code within 30 days after the Date of Grant, in lieu of the foregoing, the Grantee will be taxed at the time the Shares are granted to the Grantee on the fair market value of the Shares.

The Section 83(b) election, which may avoid adverse tax consequences in the future, must be made within the 30-day period after the Date of Grant. The form for making this election may be obtained from Dee Blackburn. **THE GRANTEE ACKNOWLEDGES THAT IT IS THE GRANTEE'S SOLE RESPONSIBILITY TO SEEK ADVICE REGARDING SECTION 83(B). THE GRANTEE REPRESENTS THAT HE OR SHE IS RELYING SOLELY ON HIS OR HER ADVISORS WITH RESPECT TO THIS SECTION 83(B) ELECTION, AND THE COMPANY SHALL HAVE NO RESPONSIBILITY OR LIABILITY IN CONNECTION THEREWITH.**

3. Withholding of Taxes. The Grantee understands that the Company shall have the right to require the Grantee to pay to the Company the amount of any taxes which the Company is required to withhold in respect of this grant or to take whatever action it deems necessary to protect the interests of the Company in respect of such tax liabilities, including, without limitation, withholding a portion of the Shares, selling for Grantee's account a portion of the Shares and applying the net proceeds thereof to the payment of such taxes, or deducting from other wages, bonuses or other amounts payable to the Grantee by the Company, any federal, state or local taxes required by law to be withheld with respect to such Grant.

The Grantee understands that Vested Shares will not be released to the Grantee until such time as the Company has received any taxes that the Company is required to withhold in respect of the Vested Shares.

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The Grantee, intending to be legally bound hereby, has executed this Acceptance of Grant as of the date set forth below.

Dated: January 8, 2007

GRANTEE:

/s/ John A. Loftus

John A. Loftus





Safeguard Scientifics, Inc., a Pennsylvania corporation (the "Company"), hereby grants to the grantee named below ("Grantee") an option (this "Option") to purchase the total number of shares shown below of Common Stock of the Company (the "Shares") at the exercise price per share set forth below, subject to all of the terms and conditions on the reverse side of this Stock Option Grant Certificate and the \_\_\_Equity Compensation Plan (the "Plan"). Unless otherwise defined herein, capitalized terms used herein shall have the meanings ascribed to them in the Plan. The terms and conditions set forth on the reverse side hereof and the terms and conditions of the Plan are incorporated herein by reference. This Stock Option Grant Certificate shall constitute the "Agreement" for this Option as such term is used in the Plan.

Grant Date: \_\_\_\_\_

Type of Option: Nonqualified Stock Option

Shares Subject to Option: \_\_\_\_\_

Exercise Price Per Share: \$ \_\_\_\_\_

Term of Option: \_\_\_\_\_ years

Shares subject to issuance under this Option will vest as follows: \_\_\_\_\_; provided, however, if Grantee's service terminates prior to the date this option would otherwise become fully vested as a result of (i) death, (ii) permanent disability, (iii) retirement on or after his or her 65th birthday, (iv) upon the occurrence of a Reorganization or Change of Control (as defined in the Plan) or (v) not being nominated by the Nominating & Corporate Governance Committee for re-election to the Company's Board of Directors, this option will be deemed fully vested as of the date of such termination of service.

In witness whereof, this Stock Option Grant Certificate has been executed by the Company by a duly authorized officer as of the date specified hereon.

Safeguard Scientifics, Inc.

By: \_\_\_\_\_  
\_\_\_\_\_

Grantee hereby acknowledges receipt of a copy of the Plan, represents that Grantee has read the Plan and understands the terms and provisions of the Plan, and accepts this Option subject to all the terms and conditions of the Plan and this Stock Option Grant Certificate. Grantee acknowledges that the grant and exercise of this Option, and the sale of Shares obtained through the exercise of this Option, may have tax implications that could result in adverse tax consequences to the Grantee and that Grantee is not relying on the Company for any tax, financial or legal advice and will consult a tax adviser prior to such exercise or disposition.



1. Option Expiration. The Option shall automatically terminate upon the happening of the first of the following events:

(a) the expiration of the 90-day period after the Grantee ceases to be employed by, or providing services to, the Company, if the termination is for any reason other than disability (as defined in the Plan), death, cause (as defined in the Plan), retirement as provided herein, or not being nominated for re-election to the Company's Board of Directors by the Corporate Governance Committee if the Compensation Committee has determined that the Grantee is a Retiring Director;

(b) the expiration of the one-year period after the Grantee ceases to be employed by, or providing services to, the Company on account of the Grantee's disability;

(c) the expiration of the one-year period after the Grantee ceases to be employed by, or providing services to, the Company if the Grantee dies while employed by the Company or within three months after the Grantee ceases to be so employed or provide such services on account of a termination described in subparagraph (a) above;

(d) the expiration of the one-year period after the Grantee's employment or service terminates as a result of retirement on or after the Grantee's sixty-fifth birthday, or after such earlier date as may be determined by the Committee, in its sole discretion, to be warranted given the particular circumstances surrounding the earlier termination of the Grantee's employment or service;

(e) the expiration of the two-year period after the Grantee's service on the Company's Board of Directors terminates as a result of not being nominated by the Nominating & Corporate Governance Committee for re-election to the Company's Board of Directors;

(f) the date on which the Grantee ceases to be employed by, or providing services to, the Company for cause; or

Notwithstanding the foregoing, in no event may the Option be exercised after the expiration of the Term of Option specified on the reverse side. Any portion of the Option that is not vested at the time the Grantee ceases to be employed by, or providing service to, the Company shall immediately terminate.

In the event a Grantee ceases to be employed by, or providing service to, the Company for cause, the Grantee shall automatically forfeit all shares underlying any exercised portion of an Option for which the Company has not yet delivered the share certificates upon refund by the Company of the exercise price paid by the Grantee for such shares.

2. Exercise Procedures.

(a) Subject to the provisions of this Stock Option Grant Certificate and the Plan, the Grantee may exercise part or all of the vested Option by giving the Company written notice of intent to exercise in the manner provided in Paragraph 11 below, specifying the number of Shares as to which the Option is to be exercised. On the delivery date, the Grantee shall pay the exercise price (i) in cash, (ii) by delivering Shares of the Company (duly endorsed for transfer or accompanied by stock powers signed in blank) which shall be valued at their fair market value on the date of delivery, or (iii) by such other method as the Committee may approve, including payment through a broker in accordance with procedures permitted by Regulation T of the Federal Reserve Board. The Committee may impose from time to time such limitations as it deems appropriate on the use of Shares of the Company to exercise the Option.

(b) The obligation of the Company to deliver Shares upon exercise of the Option shall be subject to all applicable laws, rules, and regulations and such approvals by governmental agencies as may be deemed appropriate by the Committee, including such actions as Company counsel shall deem necessary or appropriate to comply with relevant securities laws and regulations. The Company may require that the Grantee (or other person exercising the Option after the Grantee's death) represent that the Grantee is purchasing Shares for the Grantee's own account and not with a view to or for sale in connection with any distribution of the Shares, or such other representation as the Board deems appropriate. All obligations of the Company under this Stock Option Grant Certificate shall be subject to the rights of the Company as set forth in the Plan to withhold amounts required to be withheld for any taxes, if applicable. Subject to Committee approval, the Grantee may elect to satisfy any income tax withholding obligation of the Company with respect to the Option by having Shares withheld up to an amount that does not exceed the maximum marginal tax rate for federal (including FICA), state and local tax liabilities.

3. Change of Control. The provisions of the Plan applicable to a Change of Control shall apply to the Option, and, in the event of a Change of Control, the Board may take such actions as it deems appropriate pursuant to the Plan.

4. Restrictions on Exercise. Only the Grantee may exercise the Option during the Grantee's lifetime. After the Grantee's death, the Option shall be exercisable (subject to the limitations specified in the Plan) solely by the legal representatives of the Grantee, or by the person who acquires the right to exercise the Option by will or by the laws of descent and distribution, to the extent that the Option is exercisable pursuant to this Stock Option Grant Certificate. Notwithstanding the foregoing, the Committee may provide, at or after grant, that a Grantee may transfer non-qualified stock options pursuant to a domestic relations order or to family members or other persons or entities on such terms as the Committee may determine.

5. Grant Subject to Plan Provisions. This grant is made pursuant to the Plan, the terms of which are incorporated herein by reference, and in all respects shall be interpreted in accordance with the Plan. The grant and exercise of the Option are subject to the provisions of the Plan and to interpretations, regulations and determinations concerning the Plan established from time to time by the Committee in accordance with the provisions of the Plan, including, but not limited to, provisions pertaining to (i) rights and obligations with respect to withholding taxes, (ii) the registration, qualification or listing of the Shares, (iii) capital or other changes of the Company, and (iv) other requirements of applicable law. The Committee shall have the authority to interpret and construe the Option pursuant to the terms of the Plan, and its decisions shall be conclusive as to any questions arising hereunder.

6. No Employment Rights. The grant of the Option shall not confer upon the Grantee any right to be retained by or in the employ of the Company and shall not interfere in any way with the right of the Company to terminate the Grantee's employment or service at any time. The right of the Company to terminate at will the Grantee's employment or service at any time for any reason is specifically reserved. No policies,

procedures or statements of any nature by or on behalf of the Company (whether written or oral, and whether or not contained in any formal employee manual or handbook) shall be construed to modify this Grant Letter or to create express or implied obligations to the Grantee of any nature.

7. No Stockholder Rights. Neither the Grantee, nor any person entitled to exercise the Grantee's rights in the event of the Grantee's death, shall have any of the rights and privileges of a stockholder with respect to the Shares subject to the Option until certificates for Shares have been issued upon the exercise of the Option.

8. No Disclosure. The Grantee acknowledges that the Company has no duty to disclose to the Grantee any material information regarding the business of the Company or affecting the value of the Shares before or at the time of a termination of the Grantee's employment, including without limitation any plans regarding a public offering or merger involving the Company.

9. Assignment and Transfers. The rights and interests of the Grantee under this Stock Option Grant Certificate may not be sold, assigned, encumbered or otherwise transferred except, in the event of the death of the Grantee, by will or by the laws of descent and distribution. In the event of any attempt by the Grantee to alienate, assign, pledge, hypothecate, or otherwise dispose of the Option or any right hereunder, except as provided for in this Stock Option Grant Certificate, or in the event of the levy or any attachment, execution or similar process upon the rights or interests hereby conferred, the Company may terminate the Option by notice to the Grantee, and the Option and all rights hereunder shall thereupon become null and void. The rights and protections of the Company hereunder shall extend to any successors or assigns of the Company and to the Company's parents, subsidiaries, and affiliates. This Stock Option Grant Certificate may be assigned by the Company without the Grantee's consent.

10. Applicable Law. The validity, construction, interpretation and effect of this instrument shall be governed by and determined in accordance with the laws of the Commonwealth of Pennsylvania.

11. Notice. Any notice to the Company provided for in this instrument shall be addressed to the Company in care of the Chief Financial Officer at the Company's headquarters and any notice to the Grantee shall be addressed to such Grantee at the current address shown on the payroll of the Company, or to such other address as the Grantee may designate to the Company in writing. Any notice shall be delivered by hand, sent by telecopy or enclosed in a properly sealed envelope addressed as stated above, registered and deposited, postage prepaid, in a post office regularly maintained by the United States Postal Service.



**SAFEGUARD SCIENTIFICS, INC.**  
**COMPENSATION SUMMARY – NON-EMPLOYEE DIRECTORS**

During 2006, non-employee directors were compensated for their service as a director as shown in the table below:

<b>Compensation Item</b>	<b>Amount</b>
Annual Board Retainers:	
Chairman of the Board	\$50,000
Other Directors	35,000
Additional Annual Chair Retainers:	
Audit Committee Chair	10,000
Compensation Committee Chair	7,500
Nominating & Corporate Governance Committee Chair	5,000
Meeting Attendance Fees:	
Board	2,000
Committee	1,500

Effective January 1, 2007, the annual retainer for the Audit Committee Chair was increased to \$15,000.

We also reimburse non-employee directors for expenses they incur to attend Board and Committee meetings.

Each non-employee director receives an initial option grant to purchase 50,000 shares of Safeguard common stock upon initial election to the Board. Each non-employee director also receives an annual service option grant to purchase 25,000 shares. Directors' options have an eight-year term. Initial option grants vest 25% each year starting on the first anniversary of the grant date. Annual service option grants vest 100% on the first anniversary of the grant date. The exercise price is equal to the fair market value of a share of our common stock on the grant date.

Safeguard maintains a Group Deferred Stock Unit Program for Directors ("Directors' DSU Program") which allows each director, at his or her election, to receive deferred stock units in lieu of retainer and meeting fees paid to directors ("Directors' Fees"). The deferral election applies to Directors' Fees to be received for the following calendar year and remains in effect for each subsequent year unless the director elects otherwise at the end of the calendar year preceding the year in which the services are rendered. The number of deferred stock units awarded is determined by dividing the Directors' Fees by the fair market value of Safeguard's stock on the date on which the director would have otherwise received the Directors' Fees. Each director also receives a number of matching share units, based on the same fair market value calculation, equal to 25% of the Directors' Fees deferred. A director is always 100% vested in Directors' Fees deferred; the matching share units vest 100% on the first anniversary of the date the matching share units are credited to the director's account. Each deferred stock unit entitles the director to receive one share of Safeguard common stock on or about the first anniversary of the date upon which the director leaves the Safeguard Board. A director also may elect to receive the stock in annual installments over a period of up to five years after leaving the Board.



Safeguard Scientifics, Inc.  
435 Devon Park Drive, 800 Building  
Wayne, PA 19087

December 14, 2006

Christopher J. Davis  
7 Melissa Way  
Plymouth Meeting, PA 19462

Dear Mr. Davis:

This letter (hereinafter referred to as the “Agreement”) shall serve as notice to you of acceptance of your resignation of your board and officer positions as described in the next paragraph of this Agreement, effective December 15, 2006, and your resignation from employment, effective December 31, 2006 (the “Termination Date”) by Safeguard Scientifics, Inc. (“Safeguard”). In consideration of your execution of a general release of claims and non-competition agreement, Safeguard agrees to treat your cessation of employment as if it were a resignation by you with good reason under the severance agreement between you and Safeguard dated August 17, 2004 (the “Severance Agreement”).

You acknowledge that you have resigned, effective December 15, 2006, from such Boards and officer positions with Safeguard and all affiliates and partner companies of Safeguard that you hold. You agree to deliver to Safeguard any and all resignation letters acceptable to Safeguard in order to effect such resignations.

Subject to the terms and conditions set forth in this Agreement and the Severance Agreement, Safeguard shall provide you with the benefits set forth in Sections 1, 2(B), 3, 4, 5 and 6, and in the first sentence of Section 8, of the Severance Agreement and, in addition, your restricted stock grants made before October 2002 will become fully vested. These benefits, together with any benefits provided under the applicable terms of any other plan or program sponsored by the Safeguard, and applicable to you, shall be the only severance benefits or other payments in respect of your employment with Safeguard to which you shall be entitled, and will be in respect of all salary, accrued vacation and other rights that you may have against Safeguard or its affiliates.

The following points are intended to clarify certain aspects of the references in the immediately preceding paragraph:

(1) With respect to Section 1 of the Severance Agreement, your 2006 annual bonus will be finally determined by the Company at the same time as other eligible employees, but will not be less than 100 percent of your target bonus for 2006, which is \$325,000.

(2) The benefit plans reference in Section 4 of the Severance Agreement include the executive medical plan, provided that the maximum benefit under the executive medical plan will not exceed \$5,000 for each of 2007 and 2008.

(3) In lieu of the benefit described in Section 5 of the Severance Agreement relating to outplacement, at your election, the Company will pay you \$15,000.

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(4) With respect to Section 8, subject to the other terms and conditions described in this Agreement, the Board has exercised its discretion to accelerate the vesting of the 3,334 unvested deferred stock units granted to you on January 12, 2004, and the 13,540 unvested deferred stock units granted to you on April 5, 2004.

(5) It is mutually understood that you will take all of your accrued vacation days by December 31, 2006.

(6) Your account under the Executive Deferred Compensation Plan will be credited with a matching contribution for 2006 on the same basis as other members of Safeguard's executive team.

Notwithstanding anything herein to the contrary, in the event that any amounts payable or shares deliverable under this Agreement or the Severance Agreement are or would be considered deferred compensation subject to an excise tax pursuant to Section 409A of the Code (or any applicable regulations or guidance promulgated by the Secretary of the Treasury in connection therewith) if paid or delivered within six (6) months following the Termination Date, such amounts and shares shall be paid or delivered, as the case may be, without interest, at the later of the time otherwise provided under the Severance Agreement or the time that will prevent such amounts from being considered deferred compensation under Section 409A of the Code.

Enclosed are execution copies of the General Release and Agreement and the Non-Competition Agreement substantially in the forms attached to the Severance Agreement as Exhibits A and B. On or after December 31, 2006, please execute and return to us two copies of each agreement, and we will return to you one fully-executed copy of each agreement.

If this letter sets forth our agreement on the subject matter hereof, kindly sign and return to us the enclosed copy of this letter which will then constitute our legally binding agreement on this subject.

Sincerely,

Safeguard Scientifics, Inc.

By: /s/ Steven J. Feder  
Steven J. Feder  
Title Senior Vice President

I agree to the terms and conditions of this letter.

/s/ Christopher J. Davis  
Christopher J. Davis

Date: 12/14/06



Safeguard Scientifics, Inc.  
800 The Safeguard Building  
435 Devon Park Drive  
Wayne, PA 19087  
(610) 293-0060  
(610) 293-0601 (General Fax)

December 12, 2006

Mr. Stephen Zarrilli  
Penn Valley Group  
435 Devon Park Drive  
Building 700  
Wayne PA 19087

Dear Steve:

On behalf of SAFEGUARD SCIENTIFICS, INC. (the "Company"), I am delighted to set forth the terms and conditions of your consulting engagement in this letter, which will serve as our agreement (the "Agreement").

1. Services to be Performed by You.

(a) Services. In your capacity as an independent consultant and advisor to the Company, you will serve as the Company's Acting Senior Vice President, Acting Chief Administrative Officer and Acting Chief Financial Officer, with such duties and responsibilities as are customarily incident to the role of chief financial officer and as are otherwise assigned to you from time to time consistent with such role and the roles of the other positions set forth above. These duties and responsibilities include, without limitation, the preparation and filing of all filings required to be made with the Securities and Exchange Commission (the "SEC") during the term of this Agreement, the obligation to sign all such filings, all reports and certifications required by the SEC in connection therewith, and management representation letters to the Company's independent public auditors, and to support all of the Company's acquisition and divestiture activity. In addition, you agree to provide reasonable transition support to transition your responsibilities to your successor for 30 days following the commencement of such successor's service to the Company. Collectively, these duties and responsibilities are referenced in this Agreement as the "Consulting Services."

During the term of this Agreement, you shall devote sufficient time to the execution of these duties and responsibilities so as to discharge them in a professional manner consistent with the Company's historic standards of excellence and the Company's business and ethics policies. The Company recognizes that you will continue to provide services on behalf of the Penn Valley Group, and consents to your continued

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performance of such services, provided that it does not interfere with your performance of the Consulting Services.

You shall report to the Company's Chief Executive Officer.

(b) Administrative Support. The Company shall maintain an office for you at the Company's headquarters in Devon, PA and at the Company's cost and shall provide secretarial and administrative services to you as may be necessary to perform the Consulting Services.

(c) Change in Status. If, in the judgment of the Company's Chief Executive Officer, as a matter of compliance with laws, rules or regulations applicable to the Company, it should become necessary for the individual who serves as the Company's chief financial officer to serve as a common law employee of the Company, you shall undertake your commercially reasonable best efforts to negotiate terms of service that reflect that employee status.

## 2. Compensation.

(a) Retainer. The Company shall pay you a retainer of \$2,500 per day, payable as soon as practicable after the completion of each calendar month, provided that (i) the maximum retainer payment for any calendar month shall not exceed \$50,000, and (ii) your total retainer compensation in connection with your reasonable transition support to transition your responsibilities to your successor as provided in Paragraph 1(a) shall not exceed \$50,000.

(b) Equity. Effective upon the date the term of this Agreement commences (as provided in Paragraph 3), the Company shall make a grant to you of non-qualified stock options to acquire 150,000 shares of the Company's common stock pursuant to the Safeguard Scientifics, Inc. 2004 Equity Compensation Plan (the "Plan"). The option exercise price for all such stock options shall be equal to the average of the highest and lowest sales prices of a share of stock on the New York Stock Exchange on the date on which the term of this Agreement commences, or if such date is not a trading date, on the immediately preceding day on which there were stock transactions on that exchange. The grant shall be the subject of a standard Grant Instrument issued pursuant to the Plan, which shall contain the following rules:

(i) Your options shall vest and become exercisable as follows, provided that in no event shall the number of stock options that may vest under this Agreement exceed 150,000:

(1) Upon the timely and complete filing of the Company's Form 10-K for the year ending December 31, 2006 with the SEC during the term of this Agreement, the product of (x) 15,000 times (y) the number of completed calendar months elapsed from the date the term of this Agreement commences through the date of such filing.

(2) Following the timely and complete filing of the Company's Form 10-K for the year ending December 31, 2006 with the SEC, an additional 15,000 stock options shall vest on the first date of each calendar month beginning after such filing, provided that you continue to provide Consulting Services under this Agreement on each such date.

(3) Upon the satisfactory completion of your services relating to the transition of your duties and responsibilities to your successor, as determined by the Company's Chief Executive Officer in his sole discretion, or upon your appointment as the Company's Chief Financial Officer (and the removal of the term "Acting" from your titles), all stock options that have not previously vested and become exercisable shall become fully vested and exercisable.

Any stock options that remain unvested upon the termination of this Agreement shall be forfeited.

(ii) All stock options that vest under this Agreement shall continue to be exercisable, subject to the terms and conditions of the Plan and the Grant Instrument issued pursuant to the Plan, until the earlier of (A) the eighth (8<sup>th</sup>) anniversary of the date on which the term of this Agreement commences, and (B) the third (3<sup>rd</sup>) anniversary of the cessation or termination of your services as the company's acting Chief Financial Officer or Chief Financial Officer.

(d) Reimbursement of Expenses. The Company shall reimburse you in accordance with the Company's regular policies and practices for travel and other business expenses reasonably incurred by you in connection with the Company's business.

3. Term. Subject to the completion of a satisfactory background check, to which you consent, this Agreement will become effective on December 15, 2006 or such other mutually agreeable date, and will continue in effect until the earliest of (i) your death, (ii) your disability such that you are unable to continue to perform Consulting Services, (iii) the 30<sup>th</sup> day following the appointment of your successor and (iv) the termination of the Agreement by you or the Company in accordance with the next sentence. Either you or the Company may terminate this Agreement at any time and for any reason, effective on 30 days' advance notice.

4. Company Policies. You represent and warrant that you are not aware of any contractual or other restriction on your ability to provide the Consulting Services pursuant to this Agreement. You agree to be bound and subject to all material Company policies, including, without limitation, such policies relating to competition with the Company, confidentiality, use and return of Company property, and securities trading policies and restrictions, as apply to the Company's executive officers.

5. Independent Contractor Relationship. None of the provisions of this Agreement are intended to create nor shall be deemed or construed to create any relationship between you and the Company other than that of independent parties

contracting with each other solely for the purpose of effecting the provisions of this Agreement. You understand and agree that the Company will not withhold from payments made upon this Agreement any funds for income tax, unemployment insurance, social security or any other withholding pursuant to any law or requirement of any government body and all of such payments that may be required by law are your sole and exclusive responsibility. In addition, except as specifically provided in this Agreement, you shall not be eligible to participate in any plan, program or other arrangement maintained by the Company to provide benefits or compensation to employees of or other service providers to the Company, including but not limited to retirement, welfare, bonus or incentive plans, programs or arrangements. You also agree that you shall not make any claim for benefits under any such plan, program or arrangement based on your service to the Company pursuant to this Agreement.

6. Waiver. Any waiver by you or the Company of a breach of any provision of this Agreement shall not operate as or be construed to be a waiver of any other breach of such provision or of any breach of any other provision of this Agreement. The failure of you or the Company to insist upon strict adherence to any term of this Agreement on one or more occasions shall not be considered a waiver or deprive that party of the right thereafter to insist upon strict adherence to that term or any other term of this Agreement. Any waiver must be in writing.

7. Entire Agreement. This Agreement sets forth the entire understanding of the parties with respect to the subject matters hereof, supersedes all existing agreements between them concerning such subject matters, and may be modified only by a written instrument duly executed by you and the Company.

8. Assignment; Binding Effect. Your and the Company's respective rights and obligations under this Agreement shall not be transferable by assignment or otherwise without the written consent of the other parties hereto. The provisions of this Agreement shall be binding upon and inure to the benefit of and be enforceable by you and the Company and our respective heirs, executors, administrators, successors and permitted assigns.

9. Headings. The headings in this Agreement are solely for convenience of reference and shall be given no effect in the construction or interpretation of this Agreement.

10. Severability. The covenants and agreements contained herein are separate and severable and the invalidity or unenforceability of any one or more of such covenants or agreements shall not affect the validity or enforceability of any other covenant or agreement contained herein. In addition, if, in any judicial proceeding, a court shall refuse to enforce one or more of the covenants or agreements contained herein because the duration thereof is too long or the scope thereof is too broad, it is expressly agreed between you and the Company that such duration or scope shall be deemed reduced to the extent necessary to permit the enforcement of such covenants or agreements, to the extent allowed by applicable law. This Section 10 shall survive the termination of this Agreement.

11. Counterparts; Governing Law. This Agreement may be delivered via facsimile executed in counterpart, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. It shall be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania, without giving effect to the rules governing the conflicts of laws.

12. Notices. All notices and other communications hereunder shall be in writing and shall be given to the person either personally or by sending a copy thereof by first class or express mail, postage prepaid, or by fax.

If to the Consultant:

Stephen Zarrilli  
Penn Valley Group  
435 Devon Park Drive  
Building 700  
Wayne PA 19087  
Fax: 610-977-2769

If to the Company:

Safeguard Scientifics, Inc.  
800 The Safeguard Building  
435 Devon Park Drive  
Wayne, PA 19087  
Attention: General Counsel  
Fax: (610) 293-0601

\* \* \* \* \*

Steve, please accept my sincere personal thanks for your willingness to serve. I look forward to working with you.

So that we may have a record of your consent to the terms and conditions described above, please sign and date the attached copy of this Agreement and return it to me.

Cordially,  
/s/ Peter Boni

Peter Boni  
FOR SAFEGUARD SCIENTIFICS, INC.

Agreed to this 15<sup>th</sup> day of December, 2006

/s/ Stephen Zarrilli  
Stephen Zarrilli



**EIGHTH AMENDMENT  
TO  
LOAN AGREEMENT**

**THIS EIGHTH AMENDMENT TO LOAN AGREEMENT** is entered into as of February 28, 2007 (the "Amendment"), by and among **COMERICA BANK** ("Bank"), **SAFEGUARD DELAWARE, INC** ("Safeguard Delaware") and **SAFEGUARD SCIENTIFICS (DELAWARE), INC** ("Safeguard Scientifics"; Safeguard Scientifics and Safeguard Delaware are sometimes referred to, individually, as a "Borrower" and collectively, as the "Borrowers").

**RECITALS**

A. Borrowers and Bank are parties to that certain Loan Agreement dated as of May 10, 2002, as amended from time to time, including without limitation by a First Amendment to Loan Agreement dated as of May 5, 2003, a Second Amendment to Loan Agreement dated as of February 12, 2004, a Third Amendment to Loan Agreement dated as of May 8, 2004, a Fourth Amendment to Loan Agreement dated as of September 30, 2004, a Fifth Amendment to Loan Agreement dated as of May 2, 2005, a Sixth Amendment to Loan Agreement dated as of August 1, 2005, and a Seventh Amendment to Loan Agreement dated as of May 4, 2006 (as so amended, the "Agreement").

B At the request of Borrowers, Bank proposes to make available to Laureate Pharma, Inc. ("Laureate") a Credit Extension of up to \$6,000,000 (the "Equipment Line") pursuant to the Loan and Security Agreement between Bank and Laureate dated as of December 1, 2004, as amended (the "Laureate Loan Agreement"), including as amended by the Sixth Amendment to Loan and Security Agreement of even date. The Equipment Line is to be supported by a Deficiency Guaranty by Borrowers of even date (the "Deficiency Guaranty").

C. The parties desire to further amend the Agreement in accordance with the terms of this Amendment,

**NOW, THEREFORE**, the parties agree as follows:

1. The Deficiency Guaranty shall be a Private Partner Guaranty under the Agreement. Notwithstanding the other provisions of the Agreement, the Required Cash Balance in respect of the Deficiency Guaranty shall be Zero Dollars (\$0), provided that within 90 days after Bank notifies Borrowers that an Event of Default has occurred under the Laureate Loan Agreement, the Required Cash Balance shall be equal to the principal amount outstanding in respect of the Equipment Line, together with all accrued interest and fees.

2. Unless otherwise defined, all initially capitalized terms in this Amendment shall be as defined in the Agreement. The Agreement, as amended hereby, shall be and remain in full force and effect in accordance with its respective terms and hereby is ratified and confirmed in all respects. Each Borrower ratifies and reaffirms the continuing effectiveness of the Agreement and all instruments, documents and agreements entered into in connection with the Agreement.

3. Each Borrower represents and warrants that the Representations and Warranties contained in the Agreement are true and correct as of the date of this Amendment, and that no Event of Default has occurred and is continuing.

4. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument.

5. As a condition to the effectiveness of this Amendment, Bank shall have received, in form and substance satisfactory to Bank, the following:

- (a) this Amendment, duly executed by Borrowers;
  - (b) corporate resolutions to borrow, duly executed by each Borrower;
  - (c) an amount equal to all Bank Expenses incurred through the date of this Amendment; and
  - (d) such other documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.
-

IN WITNESS WHEREOF, the undersigned have executed this Amendment as of the first date above written.

SAFEGUARD DELAWARE, INC.

By: /s/ Steven J. Feder  
Title: Vice President

SAFEGUARD SCIENTIFICS  
(DELAWARE), INC.

By: /s/ Steven J. Feder  
Title: Vice President

COMERICA BANK

By: /s/ Beth Kinsey  
Title: Senior Vice President



**ALLIANCE CONSULTING GROUP ASSOCIATES, INC.  
AND  
ALLIANCE HOLDINGS, INC.  
AMENDED AND RESTATED  
LOAN AND SECURITY AGREEMENT**

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This AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT is entered into as of February 28, 2007 by and among COMERICA BANK ("Bank") and ALLIANCE CONSULTING GROUP ASSOCIATES, INC. and ALLIANCE HOLDINGS, INC. (individually, a "Borrower" and collectively, the "Borrowers").

#### RECITALS

A. Borrowers and Bank are parties to that certain Loan and Security Agreement dated as of September 25, 2003, as amended, including, without limitation, by that certain First Amendment to Loan and Security Agreement dated as of December 12, 2003, that certain Second Amendment to Loan and Security Agreement dated as of May 27, 2004, that certain Third Amendment to Loan Documents dated as of August 9, 2004, that certain Fourth Amendment to Loan Documents dated as of September 30, 2004, that certain Fifth Amendment to Loan Documents dated as of March 11, 2005, that certain Sixth Amendment to Loan Documents dated as of June 30, 2005, that certain Seventh Amendment to Loan Documents dated as of February 28, 2006, that certain Eighth Amendment and Consent to Loan Documents dated as of April 27, 2006, that certain Consent to Loan Documents dated as of July 13, 2006 and that certain Ninth Amendment and Waiver to Loan Documents dated December 29, 2006 (collectively, the "Agreement") and that certain LIBOR Addendum to Loan and Security Agreement dated as of September 25, 2003 (the "LIBOR Addendum")(the Agreement and the LIBOR Addendum, collectively, the "Original Agreement").

B. Borrowers and Bank wish to amend and restate the terms of the Original Agreement. This Agreement sets forth the terms on which Bank will advance credit to Borrowers, and Borrower will repay the amounts owing to Bank.

#### AGREEMENT

The parties agree as follows:

##### 1. DEFINITIONS AND CONSTRUCTION .

1.1 Definitions . As used in this Agreement, the following terms shall have the following definitions:

"Accounts" means all presently existing and hereafter arising accounts, contract rights, payment intangibles and all other forms of obligations owing to a Borrower arising out of the sale or lease of goods (including, without limitation, the licensing of software and other technology) or the rendering of services by a Borrower, whether or not earned by performance, and any and all credit insurance, guaranties, and other security therefor, as well as all merchandise returned to or reclaimed by Borrower and Borrower's Books relating to any of the foregoing.

"ACH Sublimit" means a sublimit for Automated Clearing House transactions under the Revolving Line of \$250,000.

"Advance" or "Advances" means a cash advance or cash advances under the Revolving Facility.

"Affiliate" means, with respect to any Person, any Person that owns or controls directly or indirectly such Person, any Person that controls or is controlled by or is under common control with such Person, and each of such Person's senior executive officers, directors, and partners. "Affiliate" shall not include any partner company of Safeguard Scientifics, Inc., Safeguard Delaware, Inc. or Safeguard Scientifics (Delaware), Inc.

"Bank Expenses" means all reasonable costs or expenses (including reasonable attorneys' fees and expenses) incurred in connection with the preparation, negotiation, administration, and enforcement of the Loan Documents; reasonable Collateral audit fees; and Bank's reasonable attorneys' fees and expenses incurred in amending, enforcing or defending the Loan Documents (including fees and expenses of appeal), incurred before, during and after an Insolvency Proceeding, whether or not suit is brought.

“Borrower’s Books” means all of a Borrower’s books and records including: ledgers; records concerning Borrower’s assets or liabilities, the Collateral, business operations or financial condition; and all computer programs, or tape files, and the equipment, containing such information.

“Borrowing Base” means an amount equal to the sum of (i) eighty five percent (85%) of Eligible Accounts plus (ii) the lesser of eighty five percent (85%) of Eligible Unbilled Accounts or \$5,000,000, in each case as determined by Bank with reference to the most recent Borrowing Base Certificate delivered by Borrower. Beginning October 1, 2007, Borrowing Base means an amount equal to the sum of (i) eighty percent (80%) of Eligible Accounts plus (ii) the lesser of eighty percent (80%) of Eligible Unbilled Accounts or \$2,500,000, in each case, as determined by Bank with reference to the most recent Borrowing Base Certificate delivered by Borrower. Beginning January 1, 2008, Borrowing Base means an amount equal to eighty percent (80%) of Eligible Accounts, as determined by Bank with reference to the most recent Borrowing Base Certificate delivered by Borrower.

“Business Day” means any day that is not a Saturday, Sunday, or other day on which banks in the State of California or the Commonwealth of Pennsylvania are authorized or required to close.

“Change in Control” means (a) a sale of all or substantially all of the assets of a Borrower, or (b) a transaction in which any “person” or “group” (within the meaning of Section 13(d) and 14(d)(2) of the Securities Exchange Act of 1934) becomes the “beneficial owner” (as defined in Rule 13d-3 under the Securities Exchange Act of 1934), directly or indirectly, of a sufficient number of shares of all classes of stock then outstanding of a Borrower ordinarily entitled to vote in the election of directors, empowering such “person” or “group” to elect a majority of the Board of Directors of a Borrower, who did not have such power before such transaction; provided that a transaction with any Affiliate of a Borrower shall not constitute a “Change of Control.”

“Closing Date” means the date of this Agreement.

“Code” means the California Uniform Commercial Code.

“Collateral” means the property described on Exhibit A attached hereto.

“Contingent Obligation” means, as applied to any Person, any direct or indirect liability, contingent or otherwise, of that Person with respect to (i) any indebtedness, lease, dividend, letter of credit or other obligation of another, including, without limitation, any such obligation directly or indirectly guaranteed, endorsed, co-made or discounted or sold with recourse by that Person, or in respect of which that Person is otherwise directly or indirectly liable; (ii) any obligations with respect to undrawn letters of credit, corporate credit cards, or merchant services issued or provided for the account of that Person; and (iii) all obligations arising under any interest rate, currency or commodity swap agreement, interest rate cap agreement, interest rate collar agreement, or other agreement or arrangement designed to protect a Person against fluctuation in interest rates, currency exchange rates or commodity prices; provided, however, that the term “Contingent Obligation” shall not include endorsements for collection or deposit in the ordinary course of business. The amount of any Contingent Obligation shall be deemed to be an amount equal to the stated or determined amount of the primary obligation in respect of which such Contingent Obligation is made or, if not stated or determinable, the maximum reasonably anticipated liability in respect thereof as determined by such Person in good faith; provided, however, that such amount shall not in any event exceed the maximum amount of the obligations under the guarantee or other support arrangement.

“Copyrights” means any and all copyright rights, copyright applications, copyright registrations and like protections in each work or authorship and derivative work thereof, whether published or unpublished and whether or not the same also constitutes a trade secret, now or hereafter existing, created, acquired or held.

“Credit Extension” means each Advance, or any other extension of credit by Bank for the benefit of Borrower hereunder.

“Current Assets” means, as of any applicable date, all amounts that should, in accordance with GAAP, be included as current assets on the consolidated balance sheet of Borrower and its Subsidiaries, as at such date.

“Current Liabilities” means, as of any applicable date, all amounts that should, in accordance with GAAP, be included as current liabilities on the consolidated balance sheet of Borrower and its Subsidiaries, as at such date, plus, to the extent not already included therein, all outstanding Credit Extensions made under this Agreement, including all Indebtedness that is payable upon demand or within one year from the date of determination thereof unless such Indebtedness is renewable or extendible at the option of Borrower or any Subsidiary to a date more than one year from the date of determination.

“Daily Balance” means the amount of the Obligations owed at the end of a given day.

“Eligible Accounts” means those Accounts that arise in the ordinary course of a Borrower’s business that comply with all of such Borrower’s representations and warranties to Bank set forth in Section 5.4; provided, that standards of eligibility may be fixed and revised from time to time by Bank in Bank’s reasonable judgment and upon notification thereof to a Borrower in accordance with the provisions hereof. Unless otherwise agreed to by Bank, Eligible Accounts shall not include the following:

- (a) Accounts that the account debtor has failed to pay within ninety (90) days of invoice date;
- (b) Accounts with respect to an account debtor, twenty-five percent (25%) of whose Accounts the account debtor has failed to pay within ninety (90) days of invoice date;
- (c) Accounts with respect to which the account debtor is an officer, employee, or agent of a Borrower;
- (d) Accounts with respect to which goods are placed on consignment, guaranteed sale, sale or return, sale on approval, bill and hold, or other terms by reason of which the payment by the account debtor may be conditional;
- (e) Accounts with respect to which the account debtor is an Affiliate of a Borrower provided, however, that Eligible Accounts shall include Accounts with respect to which the account debtor is an Affiliate of a Borrower in an aggregate amount not to exceed Five Hundred Thousand Dollars (\$500,000) at any time and only to the extent such Accounts are otherwise Eligible Accounts;
- (f) Accounts with respect to which the account debtor does not have its principal place of business in the United States, except for Eligible Foreign Accounts;
- (g) Accounts with respect to which the account debtor is the United States or any department, agency, or instrumentality of the United States, except for Accounts of the United States if the payee has assigned its payment rights to Bank and the assignment has been acknowledged under the Assignment of Claims Act of 1940 (31 U.S.C. § 3727);
- (h) Accounts with respect to which a Borrower is liable to the account debtor for goods sold or services rendered by the account debtor to a Borrower or for deposits or other property of the account debtor held by a Borrower, but only to the extent of any amounts owing to the account debtor against amounts owed to a Borrower;
- (i) Accounts with respect to an account debtor, including Subsidiaries and Affiliates, whose total obligations to Borrowers exceed twenty-five percent (25%) of all Accounts, to the extent such obligations exceed the aforementioned percentage, except as approved in writing by Bank;
- (j) Accounts with respect to which the account debtor disputes liability or makes any claim with respect thereto as to which Bank believes, in its sole discretion, that there may be a basis for dispute (but only

to the extent of the amount subject to such dispute or claim), or is subject to any Insolvency Proceeding, or becomes insolvent, or goes out of business;

(k) Accounts the collection of which Bank reasonably determines to be doubtful; and

(l) Unbilled Accounts except for Eligible Unbilled Accounts. .

“Eligible Foreign Accounts” means Accounts with respect to which the account debtor does not have its principal place of business in the United States and that (i) are supported by one or more letters of credit in an amount and of a tenor, and issued by a financial institution, acceptable to Bank, or (ii) that Bank approves on a case-by-case basis; including, without limitation, Accounts with IBM Canada Ltd. and any of its Affiliates.

“Eligible Unbilled Accounts” means Accounts that would otherwise be Eligible Accounts but have not yet been billed except for Unbilled Accounts arising from fixed fee contracts with milestone-based payments where the deliverable milestone has not been achieved. An Unbilled Account shall be ineligible if not billed by Borrower within 35 days

“Equipment” means all present and future machinery, equipment, tenant improvements, furniture, fixtures, vehicles, tools, parts and attachments in which Borrower has any interest.

“ERISA” means the Employee Retirement Income Security Act of 1974, as amended, and the regulations thereunder.

“Event of Default” has the meaning assigned in Article 8.

“GAAP” means generally accepted accounting principles as in effect from time to time.

“Guaranteed Loan Agreement” means the Loan and Security Agreement of even date between Borrowers and Bank, supported by an unconditional guaranty of Safeguard Scientifics, Inc.

“Indebtedness” means (a) all indebtedness for borrowed money or the deferred purchase price of property or services, including without limitation reimbursement and other obligations with respect to surety bonds and letters of credit, (b) all obligations evidenced by notes, bonds, debentures or similar instruments, (c) all capital lease obligations and (d) all Contingent Obligations.

“Insolvency Proceeding” means any proceeding commenced by or against any person or entity under any provision of the United States Bankruptcy Code, as amended, or under any other bankruptcy or insolvency law, including assignments for the benefit of creditors, formal or informal moratoria, compositions, extension generally with its creditors, or proceedings seeking reorganization, arrangement, or other relief.

“Intellectual Property Collateral” means all of a Borrower’s right, title, and interest in and to the following:

(a) Copyrights, Trademarks and Patents;

(b) Any and all trade secrets, and any and all intellectual property rights in computer software and computer software products now or hereafter existing, created, acquired or held;

(c) Any and all design rights which may be available to a Borrower now or hereafter existing, created, acquired or held;

(d) Any and all claims for damages by way of past, present and future infringement of any of the rights included above, with the right, but not the obligation, to sue for and collect such damages for said use or infringement of the intellectual property rights identified above;

(e) All licenses or other rights to use any of the Copyrights, Patents or Trademarks, and all license fees and royalties arising from such use to the extent permitted by such license or rights;

(f) All amendments, renewals and extensions of any of the Copyrights, Trademarks or Patents; and

(g) All proceeds and products of the foregoing, including without limitation all payments under insurance or any indemnity or warranty payable in respect of any of the foregoing;

provided however, that any of the foregoing developed by a Borrower to be used exclusively by a Borrower's customer shall not constitute "Intellectual Property Collateral".

"Inventory" means all present and future inventory in which Borrower has any interest, including merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products intended for sale or lease or to be furnished under a contract of service, of every kind and description now or at any time hereafter owned by or in the custody or possession, actual or constructive, of Borrower, including such inventory as is temporarily out of its custody or possession or in transit and including any returns upon any accounts or other proceeds, including insurance proceeds, resulting from the sale or disposition of any of the foregoing and any documents of title representing any of the above, and Borrower's Books relating to any of the foregoing.

"Investment" means any beneficial ownership of (including stock, partnership interest or other securities) any Person, or any loan, advance or capital contribution to any Person.

"IRC" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

"Letter of Credit" means a commercial or standby letter of credit or similar undertaking issued by Bank at Borrower's request in accordance with Section 2.1(a)(iii).

"Letter of Credit Sublimit" means a sublimit for Letters of Credit under the Revolving Line of \$1,565,000.

"Lien" means any mortgage, lien, deed of trust, charge, pledge, security interest or other encumbrance.

"Loan Documents" means, collectively, this Agreement, any note or notes executed by Borrower, and any other agreement entered into in connection with this Agreement, all as amended or extended from time to time.

"Material Adverse Effect" means a material adverse effect on (i) the business operations condition (financial or otherwise) or prospects of a Borrower and its Subsidiaries taken as a whole, (ii) the ability of a Borrower to repay the Obligations or otherwise perform its obligations under the Loan Documents, or (iii) the value or priority of Bank's security interests in the Collateral.

"Negotiable Collateral" means all of Borrower's present and future letters of credit of which it is a beneficiary, notes, drafts, instruments, securities, documents of title, and chattel paper, and Borrower's Books relating to any of the foregoing.

"Obligations" means all debt, principal, interest, Bank Expenses and other amounts owed to Bank by Borrower pursuant to this Agreement or any other agreement, whether absolute or contingent, due or to become due, now existing or hereafter arising, including any interest that accrues after the commencement of an Insolvency Proceeding.

"Patents" means all patents, patent applications and like protections including without limitation improvements, divisions, continuations, renewals, reissues, extensions and continuations in part of the same.

“Periodic Payments” means all installments or similar recurring payments that a Borrower may now or hereafter become obligated to pay to Bank pursuant to the terms and provisions of any instrument, or agreement now or hereafter in existence between a Borrower and Bank.

“Permitted Indebtedness” means:

(h) Indebtedness of a Borrower in favor of Bank arising under this Agreement, the Guaranteed Loan Agreement, or any other Loan Document;

(i) Indebtedness existing on the Closing Date and disclosed in the Schedule;

(j) Indebtedness secured by a lien described in clause (c) of the defined term “Permitted Liens,” provided (i) such Indebtedness does not exceed the lesser of the cost or fair market value of the equipment financed with such Indebtedness and (ii) such Indebtedness does not exceed \$250,000 in the aggregate at any given time; and

(k) Subordinated Debt.

“Permitted Investment” means:

(a) Investments existing on the Closing Date disclosed in the Schedule; and

(b) (i) marketable direct obligations issued or unconditionally guaranteed by the United States of America or any agency or any State thereof maturing within one (1) year from the date of acquisition thereof, (ii) commercial paper maturing no more than one (1) year from the date of creation thereof and currently having rating of at least A-2 or P-2 from either Standard & Poor’s Corporation or Moody’s Investors Service, (iii) certificates of deposit maturing no more than one (1) year from the date of investment therein issued by Bank, and (iv) Bank’s money market accounts.

“Permitted Liens” means the following:

(a) Any Liens existing on the Closing Date and disclosed in the Schedule or arising under this Agreement or the other Loan Documents;

(b) Liens for taxes, fees, assessments or other governmental charges or levies, either not delinquent or being contested in good faith by appropriate proceedings, provided the same have no priority over any of Bank’s security interests;

(c) Liens (i) upon or in any equipment which was not financed by Bank acquired or held by a Borrower or any of its Subsidiaries to secure the purchase price of such equipment or indebtedness incurred solely for the purpose of financing the acquisition of such equipment, or (ii) existing on such equipment at the time of its acquisition, provided that the Lien is confined solely to the property so acquired and improvements thereon, and the proceeds of such equipment; and

(d) Liens incurred in connection with the extension, renewal or refinancing of the indebtedness secured by Liens of the type described in clauses (a) through (c) above, provided that any extension, renewal or replacement Lien shall be limited to the property encumbered by the existing Lien and the principal amount of the indebtedness being extended, renewed or refinanced does not increase.

“Person” means any individual, sole proprietorship, partnership, limited liability company, joint venture, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or governmental agency.

“Prime Rate” means the variable rate of interest, per annum, most recently announced by Bank, as its “prime rate,” whether or not such announced rate is the lowest rate available from Bank.

“Responsible Officer” means each of the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer, Vice President of Finance and the Controller of Borrower.

“Revolving Facility” means the facility under which Borrowers may request Bank to issue Advances, as specified in Section 2.1(a) hereof.

“Revolving Line” means a credit extension of up to Fifteen Million Dollars (\$15,000,000).

“Revolving Maturity Date” means February 27, 2008.

“Schedule” means the schedule of exceptions attached hereto and approved by Bank, if any.

“Shares” means all of the capital stock of Alliance Consulting Group, Inc. and Mensamind, Inc. and 66% of the outstanding capital stock of Alliance IT Consulting India PVT LTD.

“Subordinated Debt” means any debt incurred by a Borrower that is subordinated to the debt owing by Borrower to Bank on terms acceptable to Bank (and identified as being such by Borrower and Bank).

“Subsidiary” means any corporation, company or partnership in which (i) any general partnership interest or (ii) more than 50% of the stock or other units of ownership which by the terms thereof has the ordinary voting power to elect the Board of Directors, managers or trustees of the entity, at the time as of which any determination is being made, is owned by a Borrower, either directly or through an Affiliate.

“Trademarks” means any trademark and servicemark rights, whether registered or not, applications to register and registrations of the same and like protections, and the entire goodwill of the business of a Borrower connected with and symbolized by such trademarks.

1.2 Accounting Terms. All accounting terms not specifically defined herein shall be construed in accordance with GAAP and all calculations made hereunder shall be made in accordance with GAAP. When used herein, the terms “financial statements” shall include the notes and schedules thereto.

## 2. LOAN AND TERMS OF PAYMENT.

### 2.1 Credit Extensions.

Borrowers promise to pay to the order of Bank, in lawful money of the United States of America, the aggregate unpaid principal amount of all Credit Extensions made by Bank to each Borrower and/or Borrowers hereunder. Borrowers shall also pay interest on the unpaid principal amount of such Credit Extensions at rates in accordance with the terms hereof.

#### (a) Revolving Advances.

(i) **Advances**. Subject to and upon the terms and conditions of this Agreement, Borrowers may request Advances in an aggregate outstanding amount not to exceed the lesser of the Revolving Line or the Borrowing Base, less any amounts outstanding under the Letter of Credit Sublimit and the ACH Sublimit. Subject to the terms and conditions of this Agreement, amounts borrowed pursuant to this Section 2.1 (a) may be repaid and reborrowed at any time prior to the Revolving Maturity Date, at which time all Advances under this Section 2.1(a) shall be immediately due and payable. Borrowers may prepay any Advances without penalty or premium.

(ii) **Procedure**. Whenever Borrowers desire an Advance, a Borrower will notify Bank by facsimile transmission or telephone no later than 3:30 p.m. Eastern time, on the Business Day that the Advance is to be made. Each such notification shall be promptly confirmed by a Payment/Advance Form in substantially the form of Exhibit B hereto. Bank is authorized to make Advances under this Agreement, based upon

instructions received from a Responsible Officer or a designee of a Responsible Officer, or without instructions if in Bank's discretion such Advances are necessary to meet Obligations which have become due and remain unpaid. Bank shall be entitled to rely on any telephonic notice given by a person who Bank reasonably believes to be a Responsible Officer or a designee thereof, and Borrower shall indemnify and hold Bank harmless for any damages or loss suffered by Bank as a result of such reliance. Bank will credit the amount of Advances made under this Section 2.1(a) to a Borrower's deposit account.

(iii) **Letter of Credit Sublimit.** Subject to the availability under the Revolving Line and the Borrowing Base, and in reliance on the representations and warranties of Borrower set forth herein, at any time and from time to time from the date hereof through the Business Day immediately prior to the Revolving Maturity Date, Bank shall issue for the account of Borrower such Letters of Credit as Borrower may request by delivering to Bank a duly executed letter of credit application on Bank's standard form; provided, however, that the outstanding and undrawn amounts under all such Letters of Credit (i) shall not at any time exceed the Letter of Credit Sublimit, and (ii) shall be deemed to constitute Advances for the purpose of calculating availability under the Revolving Line. Any drawn but unreimbursed amounts under any Letters of Credit shall be charged as Advances against the Revolving Line. All Letters of Credit shall be in form and substance acceptable to Bank in its sole discretion and shall be subject to the terms and conditions of Bank's form application and letter of credit agreement. Borrower will pay any standard issuance and other fees that Bank notifies Borrower it will charge for issuing and processing Letters of Credit.

(iv) **ACH Sublimit .** Subject to the terms and conditions of this Agreement, Borrower may request ACH origination services by delivering to Bank a duly executed ACH application on Bank's standard form; provided, however, that the total amount of the ACH processing reserves shall not exceed, and availability under the Revolving Line shall be reduced by, the ACH Sublimit. In addition, Bank may, in its sole discretion, charge as Advances any amounts that become due or owing to Bank in connection with the ACH services. If Borrower has not secured to Bank's satisfaction its obligations with respect to any ACH origination services by the Revolving Maturity Date, then, effective as of such date, the balance in any deposit accounts held by Bank and the certificates of deposit issued by Bank in Borrower's name (and any interest paid thereon or proceeds thereof, including any amounts payable upon the maturity or liquidation of such certificates), shall automatically secure such obligations to the extent of the then outstanding ACH origination services. Borrower authorizes Bank to hold such balances in pledge and to decline to honor any drafts thereon or any requests by Borrower or any other Person to pay or otherwise transfer any part of such balances for so long as the ACH origination services continue.

(v) **Collateralization of Obligations Extending Beyond Maturity .** If Borrower has not secured to Bank's satisfaction its obligations with respect to any Letters of Credit or ACH origination services by the Revolving Maturity Date, then, effective as of such date, the balance in any deposit accounts held by Bank and the certificates of deposit or time deposit accounts issued by Bank in Borrower's name (and any interest paid thereon or proceeds thereof, including any amounts payable upon the maturity or liquidation of such certificates or accounts), shall automatically secure such obligations to the extent of the then continuing or outstanding and undrawn Letters of Credit or ACH origination services. Borrower authorizes Bank to hold such balances in pledge and to decline to honor any drafts thereon or any requests by Borrower or any other Person to pay or otherwise transfer any part of such balances for so long as the Letters of Creditor ACH origination services are outstanding or continue.

**2.2 Guaranteed Loan Agreement; Overadvances.** Notwithstanding any other provisions of this Agreement, no Advances may be outstanding hereunder unless the outstanding principal balance under the Guaranteed Loan Agreement is \$5,000,000. If at any time any Advances are outstanding hereunder when the outstanding principal balance under the Guaranteed Loan Agreement is less than \$5,000,000, Borrowers shall immediately repay such Advances and all accrued interest thereon. If, at any time or for any reason, the amount of Obligations owed by Borrowers to Bank pursuant to Sections 2.1(a) and 2.1(b) of this Agreement is greater than the lesser of (i) the Revolving Line or (ii) the Borrowing Base, Borrowers shall immediately pay to Bank, in cash, the amount of such excess.

**2.3 Interest Rates, Payments, and Calculations.**

(a) Interest Rates. Except as set forth in Section 2.3(b), the Advances shall bear interest, on the outstanding daily balance thereof, at a variable rate equal to the Prime Rate.

(b) Default Rate. If any payment is not made within ten (10) days after the date such payment is due, Borrowers shall pay Bank a late fee equal to the lesser of (i) five percent (5%) of the amount of such unpaid amount or (ii) the maximum amount permitted to be charged under applicable law. All Obligations shall bear interest, from and after the occurrence and during the continuance of an Event of Default, at a rate equal to five (5) percentage points above the interest rate applicable immediately prior to the occurrence of the Event of Default.

(c) Payments. Interest hereunder shall be due and payable on the first calendar day of each month during the term hereof. Bank shall, at its option, charge such interest, all Bank Expenses, and all Periodic Payments against any of a Borrower's deposit accounts or against the Revolving Line, in which case those amounts shall thereafter accrue interest at the rate then applicable hereunder. Any interest not paid when due shall be compounded by becoming a part of the Obligations, and such interest shall thereafter accrue interest at the rate then applicable hereunder. All payments shall be free and clear of any taxes, withholdings, duties, impositions or other charges, to the end that Bank will receive the entire amount of any Obligations payable hereunder, regardless of source of payment.

(d) Computation. In the event the Prime Rate is changed from time to time hereafter, the applicable rate of interest hereunder shall be increased or decreased effective as of the day the Prime Rate is changed, by an amount equal to such change in the Prime Rate. All interest chargeable under the Loan Documents shall be computed on the basis of a three hundred sixty (360) day year for the actual number of days elapsed.

**2.4 Crediting Payments.** Prior to the occurrence of an Event of Default, Bank shall credit a wire transfer of funds, check or other item of payment to such deposit account or Obligation as Borrowers specify. After the acceleration of the Obligations and so long as the Obligations remain unpaid, the receipt by Bank of any wire transfer of funds, check, or other item of payment shall be immediately applied to conditionally reduce Obligations, but shall not be considered a payment on account unless such payment is of immediately available federal funds or unless and until such check or other item of payment is honored when presented for payment. Notwithstanding anything to the contrary contained herein, any wire transfer or payment received by Bank after 3:30 p.m. Eastern time shall be deemed to have been received by Bank as of the opening of business on the immediately following Business Day. Whenever any payment to Bank under the Loan Documents would otherwise be due (except by reason of acceleration) on a date that is not a Business Day, such payment shall instead be due on the next Business Day, and additional fees or interest, as the case may be, shall accrue and be payable for the period of such extension.

**2.5 Fees.** Borrowers shall pay to Bank the following:

(a) Facility Fee. On the Closing Date, a Facility Fee equal to \$10,000, which shall be nonrefundable;

(b) Commitment Fee. A Commitment Fee equal to one eighth of one percent (0.125%) per annum of the average unused portion of the Revolving Line. Such fee shall be payable in quarterly installments on the last day of each fiscal quarter or, in the case of the quarter in which the Revolving Maturity Date falls, on the Revolving Maturity Date. Each quarterly installment shall be calculated on the average unused portion of the Revolving Line during such fiscal quarter; and

(c) Bank Expenses. (i) On the Closing Date, all Bank Expenses incurred through the Closing Date, including reasonable attorneys' fees, and (ii) after the Closing Date, all Bank Expenses, including reasonable attorneys' fees and expenses, as and when they are billed by Bank to the Borrowers, with appropriate supporting evidence and backup information to the extent available.

2.6 Term. This Agreement shall become effective on the Closing Date and, subject to Section 13.7, shall continue in full force and effect for so long as any Obligations remain outstanding or Bank has any obligation to make Credit Extensions under this Agreement. Notwithstanding the foregoing, Bank shall have the right to terminate its obligation to make Credit Extensions under this Agreement immediately and without notice upon the occurrence and during the continuance of an Event of Default. Notwithstanding termination, Bank's Lien on the Collateral shall remain in effect for so long as any Obligations are outstanding.

### 3. CONDITIONS OF LOANS.

3.1 Conditions Precedent to Initial Credit Extension. The obligation of Bank to make the initial Credit Extension is subject to the condition precedent that Bank shall have received, in form and substance satisfactory to Bank, the following:

- (a) this Agreement;
- (b) a certificate of the Secretary of each Borrower with respect to incumbency and resolutions authorizing the execution and delivery of this Agreement;
- (c) financing statements (Form UCC-1);
- (d) an agreement to provide insurance;
- (e) a third party pledge agreement;
- (f) a subordination agreement;
- (g) the certificates representing the Shares and assignments separate from certificate for the Shares duly executed by the pledgors in blank (provided that if those certificates are not available on the Closing Date, Bank waives this condition and Borrower instead shall deliver those certificates within 15 days after the Closing Date);
- (h) payment of the fees and Bank Expenses then due specified in Section 2.5 hereof;
- (i) current financial statements of Borrowers for the most recent fiscal quarter; and
- (j) such other documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.

3.2 Conditions Precedent to all Credit Extensions. The obligation of Bank to make each Credit Extension, including the initial Credit Extension, is further subject to the following conditions:

- (a) timely receipt by Bank of the Payment/Advance Form as provided in Section 2.1; and
- (b) the representations and warranties contained in Section 5 shall be true and correct in all material respects on and as of the date of such Payment/Advance Form and on the effective date of each Credit Extension as though made at and as of each such date, and no Event of Default shall have occurred and be continuing, or would exist after giving effect to such Credit Extension (provided, however, that those representations and warranties expressly referring to another date shall be true, correct and complete in all material respects as of such date).  
The

making of each Credit Extension shall be deemed to be a representation and warranty by Borrower on the date of such Credit Extension as to the accuracy of the facts referred to in this Section 3.2.

3.3 Condition Precedent to Initial Advance . The obligation of Bank to make any Advances under the Revolving Line 45 days or more after the Closing Date is subject to the condition precedent that Borrowers shall have used commercially reasonable efforts in assisting Bank to complete an audit of the Collateral, the results of which are satisfactory to Bank.

#### 4. CREATION OF SECURITY INTEREST .

4.1 Grant of Security Interest . Each Borrower hereby grants and pledges to Bank a continuing security interest in all presently existing and hereafter acquired or arising Collateral in order to secure prompt repayment of any and all Obligations and in order to secure prompt performance by Borrower of each of its covenants and duties under the Loan Documents. Except as set forth in the Schedule, such security interest constitutes a valid, first priority security interest in the presently existing Collateral, and will constitute a valid, first priority security interest in Collateral acquired after the date hereof.

4.2 Delivery of Additional Documentation Required . Each Borrower shall from time to time execute and deliver to Bank, at the request of Bank, all Negotiable Collateral, all financing statements and other documents that Bank may reasonably request, in form satisfactory to Bank, to perfect and continue the perfection of Bank's security interests in the Collateral and in order to fully consummate all of the transactions contemplated under the Loan Documents. Borrowers from time to time may deposit with Bank specific time deposit accounts to secure specific Obligations. Borrowers authorize Bank to hold such balances in pledge and to decline to honor any drafts thereon or any request by a Borrower or any other Person to pay or otherwise transfer any part of such balances for so long as the Obligations are outstanding.

4.3 Pledge of Shares . Each Borrower pledges, assigns and grants to Bank a security interest in all the Shares, together with all proceeds and substitutions thereof, all cash, stock and other moneys and property paid thereon, all rights to subscribe for securities declared or granted in connection therewith, and all other cash and noncash proceeds of the foregoing, as security for the performance of the Obligations. On the Closing Date, the certificate or certificates for the Shares will be delivered to Bank, accompanied by an instrument of assignment duly governing the Shares, each Borrower shall cause the books of each entity whose Shares are part of the Collateral and any transfer agent to reflect the pledge of the Shares. Upon the occurrence of and Event of Default hereunder, Bank may effect the transfer of any securities included in the Collateral (including but not limited to the Shares) into the name of Bank and cause new certificates representing such securities to be issued in the name of Bank or its transferee. Unless an Event of Default shall have occurred and be continuing, each Borrower shall be entitled to exercise any voting rights with respect to the Shares and to give consents, waivers and ratifications in respect thereof, provided that no vote shall be cast or consent, waiver or ratification given or action taken which would be inconsistent with any of the terms of this Agreement or which would constitute or create any violation of any of such terms. All such rights to vote and give consents, waivers and ratifications shall terminate upon the occurrence and continuance of an Event of Default.

4.4 Right to Inspect . Bank (through any of its officers, employees, or agents) shall have the right, upon reasonable prior notice, from time to time during Borrower's usual business hours, but no more than twice a year (unless an Event of Default has occurred and is continuing), to inspect Borrower's Books and to make copies thereof and to check, test, and appraise the Collateral in order to verify a Borrower's financial condition or the amount, condition of, or any other matter relating to, the Collateral.

#### 5. REPRESENTATIONS AND WARRANTIES .

Each Borrower represents and warrants as follows:

5.1 Due Organization and Qualification . Each of Borrower and each Subsidiary is a corporation duly existing under the laws of its state of incorporation and qualified and licensed to do business in any state in which the conduct of its business or its ownership of property requires that it be so qualified.

5.2 Due Authorization; No Conflict . The execution, delivery, and performance of the Loan Documents are within Borrower's powers, have been duly authorized, and are not in conflict with nor constitute a breach of any provision contained in Borrower's Articles of Incorporation or Bylaws, nor will they constitute an event of default under any material agreement to which Borrower is a party or by which Borrower is bound. Except as disclosed in the Schedule, Borrower is not in default under any material agreement to which it is a party or by which it is bound.

5.3 No Prior Encumbrances . Borrower has good and marketable title to its property, free and clear of Liens, except for Permitted Liens.

5.4 Bona Fide Eligible Accounts . The Eligible Accounts are bona fide existing obligations. The property and services giving rise to such Eligible Accounts has been delivered or rendered to the account debtor or to the account debtor's agent for immediate and unconditional acceptance by the account debtor. Neither Borrower has received notice of actual or imminent Insolvency Proceeding of any account debtor that is included in any Borrowing Base Certificate as an Eligible Account.

5.5 Merchantable Inventory . All Inventory is in all material respects of good and marketable quality, free from all material defects, except for Inventory for which adequate reserves have been made.

5.6 Intellectual Property Collateral . Borrower is the sole owner of the Intellectual Property Collateral, except for non-exclusive licenses granted by Borrower to its customers in the ordinary course of business. Each of the Patents is valid and enforceable, and no part of the Intellectual Property Collateral has been judged invalid or unenforceable, in whole or in part, and no claim has been made that any part of the Intellectual Property Collateral violates the rights of any third party. Except as set forth in the Schedule, Borrower's rights as a licensee of intellectual property do not give rise to more than five percent (5%) of its gross revenue in any given month, including without limitation revenue derived from the sale, licensing, rendering or disposition of any product or service. Except as set forth in the Schedule, Borrower is not a party to, or bound by, any agreement that restricts the grant by Borrower of a security interest in Borrower's rights under such agreement.

5.7 Name; Location of Chief Executive Office . Except as disclosed in the Schedule, Borrower has not done business under any name other than that specified on the signature page hereof. The chief executive office of Borrower is located at the address indicated in Section 10 hereof.

5.8 Litigation . Except as set forth in the Schedule, there are no actions or proceedings pending by or against Borrower or any Subsidiary before any court or administrative agency in which an adverse decision could have a Material Adverse Effect or a material adverse effect on Borrower's interest or Bank's security interest in the Collateral.

5.9 No Material Adverse Change in Financial Statements . All consolidated and consolidating financial statements related to Borrower and any Subsidiary that Bank has received from Borrower fairly present in all material respects Borrower's financial condition as of the date thereof and Borrower's consolidated and consolidating results of operations for the period then ended. There has not been a material adverse change in the consolidated or the consolidating financial condition of Borrower since the date of the most recent of such financial statements submitted to Bank.

5.10 Solvency, Payment of Debts . Except as disclosed in the Schedule, Borrower is solvent and able to pay its debts (including trade debts) as they mature.

5.11 Regulatory Compliance . Borrower and each Subsidiary has met the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA, and no event has occurred resulting from Borrower's failure to comply with ERISA that could result in Borrower's incurring any material liability. Borrower is not an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940. Borrower is not engaged principally, or as one of the important activities, in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulations T and U of the Board of Governors of the Federal Reserve System). Borrower has complied with all the provisions of the

Federal Fair Labor Standards Act. Borrower has not violated any statutes, laws, ordinances or rules applicable to it, violation of which could have a Material Adverse Effect.

5.12 Environmental Condition. Except as disclosed in the Schedule, none of Borrower's or any Subsidiary's properties or assets has ever been used by Borrower or any Subsidiary or, to the best of Borrower's knowledge, by previous owners or operators, in the disposal of, or to produce, store, handle, treat, release, or transport, any hazardous waste or hazardous substance other than in accordance with applicable law; to the best of Borrower's knowledge, none of Borrower's properties or assets has ever been designated or identified in any manner pursuant to any environmental protection statute as a hazardous waste or hazardous substance disposal site, or a candidate for closure pursuant to any environmental protection statute; no lien arising under any environmental protection statute has attached to any revenues or to any real or personal property owned by Borrower or any Subsidiary; and neither Borrower nor any Subsidiary has received a summons, citation, notice, or directive from the Environmental Protection Agency or any other federal, state or other governmental agency concerning any action or omission by Borrower or any Subsidiary resulting in the releasing, or otherwise disposing of hazardous waste or hazardous substances into the environment.

5.13 Taxes. Except as disclosed in the Schedule, Borrower and each Subsidiary has filed or caused to be filed all tax returns required to be filed, and has paid, or has made adequate provision for the payment of, all taxes reflected therein.

5.14 Subsidiaries. Borrower does not own any stock, partnership interest or other equity securities of any Person, except for Permitted Investments.

5.15 Government Consents. Borrower and each Subsidiary has obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all governmental authorities that are necessary for the continued operation of Borrower's business as currently conducted, the failure to obtain which could have a Material Adverse Effect.

5.16 Accounts. None of Borrower's property is maintained or invested with a Person other than Bank. None of any Subsidiary's property within the United States is maintained or invested with a Person other than Bank.

5.17 Full Disclosure. No representation, warranty or other statement made by Borrower in any certificate or written statement furnished to Bank contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements contained in such certificates or statements not misleading.

5.18 Shares. Borrower has full power and authority to create a first lien on the Shares and no disability or contractual obligations exists that would prohibit Borrower from pledging the Shares pursuant to this Agreement. There are no subscriptions, warrants, rights of first refusal or other restrictions on transfer relative to, or options exercisable with respect to the Shares. The Shares have been and will remain duly authorized and validly issued, and are fully paid and non-assessable. The Shares are not the subject of any present or threatened suit, action, arbitration, administrative or other proceeding, and Borrower knows of no reasonable grounds for the institution of any such proceedings.

## 6. AFFIRMATIVE COVENANTS.

Each Borrower covenants and agrees that, until payment in full of all outstanding Obligations, and for so long as Bank may have any commitment to make a Credit Extension hereunder, each Borrower shall do all of the following:

6.1 Good Standing. Borrower shall maintain its and each of its Subsidiaries' corporate existence and good standing in its jurisdiction of incorporation and maintain qualification in each jurisdiction in which it is required under applicable law. Borrower shall maintain, and shall cause each of its Subsidiaries to maintain, in force all licenses, approvals and agreements, the loss of which could have a Material Adverse Effect.

6.2 Government Compliance . Borrower shall meet, and shall cause each Subsidiary to meet, the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA. Borrower shall comply, and shall cause each Subsidiary to comply, with all statutes, laws, ordinances and government rules and regulations to which it is subject, noncompliance with which could have a Material Adverse Effect.

6.3 Financial Statements, Reports, Certificates . Each Borrower shall deliver the following to Bank: (a) as soon as available, but in any event within thirty (30) days after the end of each calendar month, a company prepared consolidated balance sheet, income, and cash flow statement covering Borrower's consolidated operations during such period, prepared in accordance with GAAP, consistently applied, in a form acceptable to Bank and certified by a Responsible Officer; (b) as soon as available, but in any event within ninety (90) days after the end of Borrower's fiscal year, audited consolidated financial statements of Borrower prepared in accordance with GAAP, consistently applied, together with an unqualified opinion on such financial statements of an independent certified public accounting firm reasonably acceptable to Bank; (c) as soon as available, but in any event within forty-five (45) days after the end of each fiscal quarter and each fiscal year, consolidating financial statements of Alliance Holdings, Inc. prepared in accordance with GAAP, consistently applied, in a form acceptable to Bank; (d) copies of all quarterly and annual statements, reports and material notices sent or made available generally by Borrower to its security holders or to any holders of Subordinated Debt and, if applicable, all reports on Forms 10-K and 10-Q filed with the Securities and Exchange Commission; (e) promptly upon receipt of notice thereof, a report of any legal actions pending or threatened against Borrower or any Subsidiary that could result in damages or costs to Borrower or any Subsidiary of \$100,000 or more; (f) such budgets, sales projections, operating plans or other financial information as Bank may reasonably request from time to time; and (g) within thirty (30) days after the last day of each fiscal quarter, a report signed by Borrower, in form reasonably acceptable to Bank, listing any applications or registrations that Borrower has made or filed in respect of any Patents, Copyrights or Trademarks and the status of any outstanding applications or registrations, as well as any material change in Borrower's intellectual property, including but not limited to any subsequent ownership right of Borrower in or to any Trademark, Patent or Copyright not specified in Exhibits A, B, and C of the Intellectual Property Security Agreement delivered to Bank by Borrower in connection with this Agreement.

Within twenty (20) days after the last day of each month (or on Friday of each week when Advances are outstanding), Borrower shall deliver to Bank a Borrowing Base Certificate signed by a Responsible Officer in substantially the form of Exhibit C hereto, together with aged listings of billed accounts receivable and accounts payable and a days revenue outstanding report in respect of unbilled receivables.

Borrower shall deliver to Bank with the monthly financial statements a Compliance Certificate signed by a Responsible Officer in substantially the form of Exhibit D hereto.

Bank shall have a right from time to time hereafter to audit Borrower's Accounts and appraise Collateral at Borrower's expense, provided that such audits will be conducted no more often than every six (6) months unless an Event of Default has occurred and is continuing and the fees for such audits shall be reasonable and customary for a transaction of this type.

6.4 Inventory; Returns . Borrower shall keep all Inventory in good and marketable condition, free from all material defects except for Inventory for which adequate reserves have been made. Returns and allowances, if any, as between Borrower and its account debtors shall be on the same basis and in accordance with the usual customary practices of Borrower, as they exist at the time of the execution and delivery of this Agreement. Borrower shall promptly notify Bank of all returns and recoveries and of all disputes and claims, where the return, recovery, dispute or claim involves more than \$100,000.

6.5 Taxes . Except as disclosed in the Schedule, Borrower shall make, and shall cause each Subsidiary to make, due and timely payment or deposit of all material federal, state, and local taxes, assessments, or contributions required of it by law, and will execute and deliver to Bank, on demand, appropriate certificates attesting to the payment or deposit thereof; and Borrower will make, and will cause each Subsidiary to make, timely payment or deposit of all material tax payments and withholding taxes required of it by applicable laws, including, but not limited to, those laws concerning F.I.C.A., F.U.T.A., state disability, and local, state, and federal income taxes, and will, upon request, furnish Bank with proof satisfactory to Bank indicating that Borrower or a Subsidiary has made such payments or deposits; provided that Borrower or a Subsidiary need not make any payment if the amount or validity of such

payment is contested in good faith by appropriate proceedings and is reserved against (to the extent required by GAAP) by Borrower.

**6.6 Insurance.**

(a) Borrower, at its expense, shall keep the Collateral insured against loss or damage by fire, theft, explosion, sprinklers, and all other hazards and risks, and in such amounts, as ordinarily insured against by other owners in similar businesses conducted in the locations where Borrower's business is conducted on the date hereof. Borrower shall also maintain insurance relating to Borrower's business, ownership and use of the Collateral in amounts and of a type that are customary to businesses similar to Borrower's.

(b) All such policies of insurance shall be in such form, with such companies, and in such amounts as are reasonably satisfactory to Bank. All such policies of property insurance shall contain a lender's loss payable endorsement, in a form satisfactory to Bank, showing Bank as an additional loss payee thereof, and all liability insurance policies shall show the Bank as an additional insured and shall specify that the insurer must give at least twenty (20) days notice to Bank before canceling its policy for any reason. Upon Bank's request, Borrower shall deliver to Bank certified copies of such policies of insurance and evidence of the payments of all premiums therefor. All proceeds payable under any such policy shall, at the option of Bank, be payable to Bank to be applied on account of the Obligations.

**6.7 Accounts.** Borrower shall maintain and shall cause each of its Subsidiaries to maintain its domestic depository, operating, and investment accounts with Bank and/or its Affiliates.

**6.8 Profitability.** Beginning February 28, 2007, as of the last day of each month, Borrowers on a consolidated basis shall maintain pre-tax profit as indicated for the three months immediately preceding each date of measurement:

<b>Period measured</b>	<b>Pre-tax profit</b>
Closing Date through 06/30/2007	(\$ 700,000)
7/1/2007 through 8/31/2007	\$ 1.00
9/1/2007 through 12/30/2007	\$ 500,000
12/31/2007 thereafter	\$1,000,000

**6.9 Current Ratio.** Borrowers shall maintain at all times, on a consolidated basis, measured as of the last day of each calendar month, a ratio of Current Assets to Current Liabilities plus, to the extent not already included therein, all Indebtedness (including without limitation any Contingent Obligations) owing from Borrower to Bank, less deferred revenue, of at least 0.90 to 1.00 through October 31, 2007, and 1.00 to 1.00 thereafter.

**6.10 Consultant Utilization.** Borrowers' Consultant Utilization (salaried and hourly) shall be equal to or greater than 75% at all times. As used herein, "Consultant Utilization" means (a) all hours billed by Borrower to a client for consulting work divided by (b) all hours paid by Borrower to an hourly consultant or worked by Borrower's salaried employees which perform consulting services.

**6.11 Lockbox.**

(a) Borrower shall maintain at all times an account at Bank (the "Lockbox") into which all funds received by Borrower from any source shall immediately be deposited. Borrower shall direct all customers to mail or deliver all checks or other forms of payment for amounts owing to Borrower to a post office box designated by Bank, over which Bank shall have exclusive and unrestricted access. All funds received by Borrower from any source shall immediately be directed to the Lockbox. Bank shall collect the mail delivered to such post office box, open such mail, and endorse and credit all items to the Lockbox. Borrower shall direct all

customers or other persons owing money to Borrower who make payments by electronic transfer of funds to wire such funds directly to the Lockbox. Borrower shall hold in trust for Bank all amounts that Borrower receives despite the directions to make payments to the post office box or Lockbox, and immediately deliver such payments to Bank in their original form as received from the customer, with proper endorsements for deposit into the Lockbox. Borrower irrevocably authorizes Bank to transfer to the Lockbox any funds that have been deposited into any other accounts or that Bank has received by wire transfer, check, cash, or otherwise. Borrower shall not establish or maintain any accounts with any Person other than Bank except for accounts opened in the ordinary course of business from which all funds are transferred on a daily basis to the Lockbox. Bank shall have all right, title and interest in all of the items from time to time in the Lockbox and their proceeds.

(b) All funds flowing through the Lockbox shall automatically be transferred into a cash collateral account at Bank in Borrower's name (the "Cash Collateral Account"), over which Bank shall have exclusive and unrestricted access. Bank shall have all right, title and interest in all of the items from time to time flowing through the Lockbox and/or held in the Cash Collateral Account and their proceeds. Neither Borrower nor any person claiming through Borrower shall have any right or control over the use of, or any right to withdraw any amount from, the Lockbox, which shall be under the sole control of Bank. Borrower shall direct all customers or other persons owing money to Borrower who make payments by electronic transfer of funds to wire such funds directly to the Cash Collateral Account

(c) Bank may apply amounts held in the Cash Collateral Account to the outstanding balance of the Obligations on a daily basis. Borrower shall open an operating account or operating accounts at Bank (collectively, the "Operating Account"). Unless an Event of Default has occurred and is continuing, after Bank applies any amounts in the Cash Collateral Account to the Obligations, Bank shall transfer the balance to the Operating Account. Bank may from time to time in its discretion make Advances to Borrowers to cover checks or other items or charges that a Borrower has drawn or made against the Operating Account or to cause payment of amounts due under the Loan Documents. Each Borrower authorizes Bank to make such Advances from time to time by means of appropriate entries of credits to the Operating Account sufficient to cover any such charges then presented, such Advances to be subject to the terms of this Agreement as through made pursuant to a Payment/Advance Form delivered by Borrowers.

#### 6.12 Intellectual Property Rights .

(a) Borrower shall register or cause to be registered (to the extent not already registered) with the United States Patent and Trademark Office or the United States Copyright Office, as the case may be, those registerable intellectual property rights now owned or hereafter developed or acquired by Borrower, to the extent that Borrower, in its reasonable business judgment, deems it appropriate to so protect such intellectual property rights.

(b) Borrower shall promptly give Bank written notice of any applications or registrations of intellectual property rights filed with the United States Patent and Trademark Office, including the date of such filing and the registration or application numbers, if any. Borrower shall (i) give Bank not less than 30 days prior written notice of the filing of any applications or registrations with the United States Copyright Office, including the title of such intellectual property rights to be registered, as such title will appear on such applications or registrations, and the date such applications or registrations will be filed, and (ii) prior to the filing of any such applications or registrations, shall execute such documents as Bank may reasonably request for Bank to maintain its perfection in such intellectual property rights to be registered by Borrower, and upon the request of Bank, shall file such documents simultaneously with the filing of any such applications or registrations. Upon filing any such applications or registrations with the United States Copyright Office, Borrower shall promptly provide Bank with (i) a copy of such applications or registrations, without the exhibits, if any, thereto, (ii) evidence of the filing of any documents requested by Bank to be filed for Bank to maintain the perfection and priority of its security interest in such intellectual property rights, and (iii) the date of such filing.

(c) Borrower shall execute and deliver such additional instruments and documents from time to time as Bank shall reasonably request to perfect and maintain the priority of Bank's security interest in the Intellectual Property Collateral. Borrower shall (i) protect, defend and maintain the validity and enforceability of the trade secrets, Trademarks, Patents and Copyrights, (ii) use commercially reasonable efforts to detect infringements of the

Trademarks, Patents and Copyrights and promptly advise Bank in writing of material infringements detected and (iii) not allow any material Trademarks, Patents or Copyrights to be abandoned, forfeited or dedicated to the public without the written consent of Bank, which shall not be unreasonably withheld.

(d) Bank may audit Borrower's Intellectual Property Collateral to confirm compliance with this Section, provided such audit may not occur more often than twice per year, unless an Event of Default has occurred and is continuing. Bank shall have the right, but not the obligation, to take, at Borrower's sole expense, any actions that Borrower is required under this Section to take but which Borrower fails to take, after 15 days' notice to Borrower. Borrower shall reimburse and indemnify Bank for all reasonable costs and reasonable expenses incurred in the reasonable exercise of its rights under this Section.

6.13 Further Assurances. At any time and from time to time Borrower shall execute and deliver such further instruments and take such further action as may reasonably be requested by Bank to effect the purposes of this Agreement.

## 7. NEGATIVE COVENANTS.

Each Borrower covenants and agrees that, so long as any credit hereunder shall be available and until payment in full of the outstanding Obligations or for so long as Bank may have any commitment to make any Credit Extensions, no Borrower will do any of the following:

7.1 Dispositions. Without Bank's prior written consent, which shall not be unreasonably withheld, except as disclosed in the Schedule, convey, sell, lease, transfer or otherwise dispose of (collectively, a "Transfer"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property, other than: (i) Transfers of Inventory in the ordinary course of business; (ii) Transfers of non-exclusive licenses and similar arrangements for the use of the property of Borrower or its Subsidiaries in the ordinary course of business; or (iii) Transfers of worn-out or obsolete Equipment.

7.2 Change in Business; Change in Control or Executive Office. Without Bank's prior written consent, which shall not be unreasonably withheld, engage in any business, or permit any of its Subsidiaries to engage in any business, other than the businesses currently engaged in by Borrower and any business substantially similar or related thereto (or incidental thereto); or cease to conduct business in the manner conducted by Borrower as of the Closing Date; or suffer or permit a Change in Control; or without thirty (30) days prior written notification to Bank, relocate its chief executive office or state of incorporation or change its legal name; or without Bank's prior written consent, change the date on which its fiscal year ends.

7.3 Mergers or Acquisitions. Without Bank's prior written consent, which shall not be unreasonably withheld, merge or consolidate; or permit any of its Subsidiaries to merge or consolidate, with or into any other business organization (other than any Affiliate of a Borrower); or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person (other than any Affiliate of a Borrower).

7.4 Indebtedness. Create, incur, assume or be or remain liable with respect to any Indebtedness, or permit any Subsidiary so to do, other than Permitted Indebtedness.

7.5 Encumbrances. Create, incur, assume or suffer to exist any Lien with respect to any of its property, or assign or otherwise convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries so to do, except for Permitted Liens. Agree with any Person other than Bank not to grant a security interest in, or otherwise encumber, any of its property, or permit any Subsidiary to do so.

7.6 Distributions. Pay any dividends or make any other distribution or payment on account of or in redemption, retirement or purchase of any capital stock, or permit any of its Subsidiaries to do so, except that Borrower may repurchase the stock of former employees pursuant to stock repurchase agreements as long as an Event of Default does not exist prior to such repurchase or would not exist after giving effect to such repurchase.

7.7 Investments . Directly or indirectly acquire or own, or make any Investment in or to any Person, or permit any of its Subsidiaries to do, other than Permitted Investments; or maintain or invest any of its property with a Person other than Bank or permit any of its Subsidiaries to do so unless such Person has entered into an account control agreement with Bank in form and substance satisfactory to Bank; or suffer or permit any Subsidiary to be a party to, or be bound by, an agreement that restricts such Subsidiary from paying dividends or otherwise distributing property to Borrower.

7.8 Transactions with Affiliates . Directly or indirectly enter into or permit to exist any material transaction with any Affiliate of Borrower except for transactions that are in the ordinary course of Borrower's business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm's length transaction with a non-affiliated Person.

7.9 Subordinated Debt . Make any payment in respect of any Subordinated Debt, or permit any of its Subsidiaries to make any such payment, except in compliance with the terms of such Subordinated Debt, or amend any provision contained in any documentation relating to the Subordinated Debt without Bank's prior written consent.

7.10 Inventory and Equipment . Store the Inventory or the Equipment with a bailee, warehouseman, or other third party unless the third party has been notified of Bank's security interest and Bank (a) has received an acknowledgment from the third party that it is holding or will hold the Inventory or Equipment for Bank's benefit or (b) is in pledge possession of the warehouse receipt, where negotiable, covering such Inventory or Equipment. Store or maintain any Equipment or Inventory at a location other than the location set forth in Section 10 of this Agreement.

7.11 Compliance . Become an "investment company" or be controlled by an "investment company," within the meaning of the Investment Company Act of 1940, or become principally engaged in, or undertake as one of its important activities, the business of extending credit for the purpose of purchasing or carrying margin stock, or use the proceeds of any Credit Extension for such purpose. Fail to meet the minimum funding requirements of ERISA, permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur, fail to comply with the Federal Fair Labor Standards Act or violate any law or regulation, which violation could have a Material Adverse Effect or a material adverse effect on the Collateral or the priority of Bank's Lien on the Collateral, or permit any of its Subsidiaries to do any of the foregoing.

## 8. EVENTS OF DEFAULT .

Any one or more of the following events shall constitute an "Event of Default" by Borrowers under this Agreement:

8.1 Payment Default . If Borrowers fail to pay any of the Obligations within three (3) days after the date when due;

8.2 Covenant Default . If a Borrower fails to perform any obligation under Article 6 or violates any of the covenants contained in Article 7 of this Agreement, or fails or neglects to perform, keep, or observe any other material term, provision, condition, covenant, or agreement contained in this Agreement, in any of the Loan Documents, or in any other present or future agreement between a Borrower and Bank and as to any default under such other term, provision, condition, covenant or agreement; and a Borrower has failed to cure such default within ten (10) days after a Borrower receives notice thereof or any officer of a Borrower becomes aware thereof; provided, however, that if the default cannot by its nature be cured within the ten (10) day period or cannot after diligent attempts by Borrowers be cured within such ten (10) day period, and such default is likely to be cured within a reasonable time, then Borrowers shall have an additional reasonable period (which shall not in any case exceed thirty (30) days) to attempt to cure such default, and within such reasonable time period the failure to have cured such default shall not be deemed an Event of Default but no Credit Extensions will be made;

8.3 Material Adverse Effect . If there occurs any circumstance or circumstances that could reasonably be expected to have a Material Adverse Effect;

8.4 Attachment. If any portion of a Borrower's assets is attached, seized, subjected to a writ or distress warrant, or is levied upon, or comes into the possession of any trustee, receiver or person acting in a similar capacity and such attachment, seizure, writ or distress warrant or levy has not been removed, discharged or rescinded within ten (10) days, or if a Borrower is enjoined, restrained, or in any way prevented by court order from continuing to conduct all or any material part of its business affairs, or if a judgment or other claim becomes a lien or encumbrance upon any material portion of a Borrower's assets, or if a notice of lien, levy, or assessment is filed of record with respect to any of a Borrower's assets by the United States Government, or any department, agency, or instrumentality thereof, or by any state, county, municipal, or governmental agency, and the same is not paid within ten (10) days after a Borrower receives notice thereof, provided that none of the foregoing shall constitute an Event of Default where such action or event is stayed or an adequate bond has been posted pending a good faith contest by Borrowers (provided that no Credit Extensions will be required to be made during such cure period);

8.5 Insolvency. If a Borrower becomes insolvent, or if an Insolvency Proceeding is commenced by a Borrower, or if an Insolvency Proceeding is commenced against a Borrower and is not dismissed or stayed within thirty (30) days (provided that no Credit Extensions will be made prior to the dismissal of such Insolvency Proceeding);

8.6 Other Agreements. If there is a default or other failure to perform in any agreement to which a Borrower is a party or by which it is bound resulting in a right by a third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness in an amount in excess of \$100,000); or which could have a Material Adverse Effect;

8.7 Subordinated Debt. If a Borrower makes any payment on account of Subordinated Debt, except to the extent such payment is allowed under any subordination agreement entered into with Bank;

8.8 Judgments. If a judgment or judgments for the payment of money in an amount, individually or in the aggregate, of at least \$100,000 shall be rendered against a Borrower and shall remain unsatisfied and unstayed for a period of ten (10) days (provided that no Credit Extensions will be made prior to the satisfaction or stay of such judgment);

8.9 Misrepresentations. If any material misrepresentation or material misstatement exists now or hereafter in any warranty or representation set forth herein or in any certificate delivered to Bank by any Responsible Officer pursuant to this Agreement or to induce Bank to enter into this Agreement or any other Loan Document; or

8.10 Guaranty. If any guaranty of all or a portion of the Obligations (a "Guaranty") ceases for any reason to be in full force and effect, or any guarantor fails to perform any obligation under any Guaranty or a security agreement securing any Guaranty (collectively, the "Guaranty Documents"), or any event of default occurs under any Guaranty Document or any guarantor revokes or purports to revoke a Guaranty, or any material misrepresentation or material misstatement exists now or hereafter in any warranty or representation set forth in any Guaranty Document or in any certificate delivered to Bank in connection with any Guaranty Document, or if any of the circumstances described in Sections 8.3 through 8.9 occur with respect to any guarantor or any guarantor dies or becomes subject to any criminal prosecution.

## 9. BANK'S RIGHTS AND REMEDIES.

9.1 Rights and Remedies. Upon the occurrence and during the continuance of an Event of Default, Bank may, at its election, without prior notice (but with notice promptly after the election of the Bank to so act) of its election and without demand, do any one or more of the following, all of which are authorized by each Borrower:

(a) Declare all Obligations, whether evidenced by this Agreement, by any of the other Loan Documents, or otherwise, immediately due and payable (provided that upon the occurrence of an Event of Default described in Section 8.5 all Obligations shall become immediately due and payable without any action by Bank);

(b) Demand that Borrower (i) deposit cash with Bank in an amount equal to the amount of any Letters of Credit remaining undrawn, as collateral security for the repayment of any future drawings under

such Letters of Credit, and (ii) pay in advance all Letter of Credit fees scheduled to be paid or payable over the remaining term of the Letters of Credit, and Borrower shall promptly deposit and pay such amounts;

(c) Cease advancing money or extending credit to or for the benefit of Borrower under this Agreement or under any other agreement between Borrower and Bank;

(d) Settle or adjust disputes and claims directly with account debtors for amounts, upon terms and in whatever order that Bank reasonably considers advisable;

(e) Make such payments and do such acts as Bank considers necessary or reasonable to protect its security interest in the Collateral. Borrower agrees to assemble the Collateral if Bank so requires, and to make the Collateral available to Bank as Bank may designate. Borrower authorizes Bank to enter the premises where the Collateral is located, to take and maintain possession of the Collateral, or any part of it, and to pay, purchase, contest, or compromise any encumbrance, charge, or lien which in Bank's determination appears to be prior or superior to its security interest and to pay all expenses incurred in connection therewith. With respect to any of Borrower's owned premises, Borrower hereby grants Bank a license to enter into possession of such premises and to occupy the same, without charge, in order to exercise any of Bank's rights or remedies provided herein, at law, in equity, or otherwise;

(f) Set off and apply to the Obligations any and all (i) balances and deposits of Borrower held by Bank, or (ii) indebtedness at any time owing to or for the credit or the account of Borrower held by Bank;

(g) Ship, reclaim, recover, store, finish, maintain, repair, prepare for sale, advertise for sale, and sell (in the manner provided for herein) the Collateral. Bank is hereby granted a license or other right, solely pursuant to the provisions of this Section 9.1, to use, without charge, Borrower's labels, patents, copyrights, rights of use of any name, trade secrets, trade names, trademarks, service marks, and advertising matter, or any property of a similar nature, as it pertains to the Collateral, in completing production of, advertising for sale, and selling any Collateral and, in connection with Bank's exercise of its rights under this Section 9.1, Borrower's rights under all licenses and all franchise agreements shall inure to Bank's benefit;

(h) Dispose of the Collateral by way of one or more contracts or transactions, for cash or on terms, in such manner and at such places (including Borrower's premises) as Bank determines is commercially reasonable, and apply any proceeds to the Obligations in whatever manner or order Bank deems appropriate;

(i) Bank may credit bid and purchase at any public sale; and

(j) Any deficiency that exists after disposition of the Collateral as provided above will be paid immediately by Borrowers.

**9.2 Power of Attorney.** Effective only upon the occurrence and during the continuance of an Event of Default, each Borrower hereby irrevocably appoints Bank (and any of Bank's designated officers, or employees) as such Borrower's true and lawful attorney to: (a) send requests for verification of Accounts or notify account debtors of Bank's security interest in the Accounts; (b) endorse Borrower's name on any checks or other forms of payment or security that may come into Bank's possession; (c) sign Borrower's name on any invoice or bill of lading relating to any Account, drafts against account debtors, schedules and assignments of Accounts, verifications of Accounts, and notices to account debtors; (d) dispose of any Collateral; (e) make, settle, and adjust all claims under and decisions with respect to Borrower's policies of insurance; (f) settle and adjust disputes and claims respecting the accounts directly with account debtors, for amounts and upon terms which Bank determines to be reasonable; (g) to file, in its sole discretion, one or more financing or continuation statements and amendments thereto, relative to any of the Collateral; and (h) to transfer the Intellectual Property Collateral into the name of Bank or a third party to the extent permitted under the California Uniform Commercial Code; provided Bank may exercise such power of attorney to sign the name of Borrower on any of the documents described in Section 4.2 regardless of whether an Event of Default has occurred, including without limitation to modify, in its sole discretion, any intellectual property security agreement entered into between Borrower and Bank without first obtaining Borrower's approval of or signature to such modification by amending Exhibits A, B, and C, thereof, as appropriate, to include reference to any right, title or interest

in any Copyrights, Patents or Trademarks acquired by Borrower after the execution hereof or to delete any reference to any right, title or interest in any Copyrights, Patents or Trademarks in which Borrower no longer has or claims to have any right, title or interest. The appointment of Bank as each Borrower's attorney in fact, and each and every one of Bank's rights and powers, being coupled with an interest, is irrevocable until all of the Obligations have been fully repaid and performed and Bank's obligation to provide Credit Extensions hereunder is terminated.

9.3 Accounts Collection . At any time during the occurrence and continuation of an Event of Default, Bank may notify any Person owing funds to a Borrower of Bank's security interest in such funds and verify the amount of such Account. Each Borrower shall collect all amounts owing to such Borrower for Bank, receive in trust all payments as Bank's trustee, and immediately deliver such payments to Bank in their original form as received from the account debtor, with proper endorsements for deposit.

9.4 Bank Expenses . If a Borrower fails to pay any amounts or furnish any required proof of payment due to third persons or entities, as required under the terms of this Agreement, then Bank may do any or all of the following after reasonable notice to Borrowers: (a) make payment of the same or any part thereof; (b) set up such reserves under a loan facility in Section 2.1 as Bank deems necessary to protect Bank from the exposure created by such failure; or (c) obtain and maintain insurance policies of the type discussed in Section 6.6 of this Agreement, and take any action with respect to such policies as Bank deems prudent. Any amounts so paid or deposited by Bank shall constitute Bank Expenses, shall be immediately due and payable, and shall bear interest at the then applicable rate hereinabove provided, and shall be secured by the Collateral. Any payments made by Bank shall not constitute an agreement by Bank to make similar payments in the future or a waiver by Bank of any Event of Default under this Agreement.

9.5 Bank's Liability for Collateral . So long as Bank complies with reasonable banking practices and its actions do not constitute gross negligence or willful misconduct, Bank shall not in any way or manner be liable or responsible for: (a) the safekeeping of the Collateral; (b) any loss or damage thereto occurring or arising in any manner or fashion from any cause; (c) any diminution in the value thereof; or (d) any act or default of any carrier, warehouseman, bailee, forwarding agency, or other person whomsoever. Except as set forth in the previous sentence, all risk of loss, damage or destruction of the Collateral shall be borne by Borrowers.

9.6 Remedies Cumulative . Bank's rights and remedies under this Agreement, the Loan Documents, and all other agreements shall be cumulative. Bank shall have all other rights and remedies not inconsistent herewith as provided under the Code, by law, or in equity. No exercise by Bank of one right or remedy shall be deemed an election, and no waiver by Bank of any Event of Default on a Borrower's part shall be deemed a continuing waiver. No delay by Bank shall constitute a waiver, election, or acquiescence by it. No waiver by Bank shall be effective unless made in a written document signed on behalf of Bank and then shall be effective only in the specific instance and for the specific purpose for which it was given.

9.7 Demand; Protest . Each Borrower waives demand, protest, notice of protest, notice of default or dishonor, notice of payment and nonpayment, notice of any default, nonpayment at maturity, release, compromise, settlement, extension, or renewal of accounts, documents, instruments, chattel paper, and guarantees at any time held by Bank on which a Borrower may in any way be liable.

## 10. NOTICES .

Unless otherwise provided in this Agreement, all notices or demands by any party relating to this Agreement or any other agreement entered into in connection herewith shall be in writing and (except for financial statements and other informational documents which may be sent by first-class mail, postage prepaid) shall be personally delivered or sent by a recognized overnight delivery service, certified mail, postage prepaid, return receipt requested, or by telefacsimile to Borrowers or to Bank, as the case may be, at its addresses set forth below:

If to any Borrower: Alliance Consulting Group Associates, Inc. and  
Alliance Holdings, Inc.  
Six Tower Bridge  
181 Washington Street  
Suite 350  
Conshohocken, PA 19428  
Attn: Chief Financial Officer  
FAX: 610-234-4331

If to Bank: Comerica Bank  
  
75 E Trimble Road  
Mail Code 4770  
San Jose, CA 95131  
Attn: Manager  
FAX: (408) 556-5091

with a copy to: Comerica Bank  
11921 Freedom Drive  
Suite 920  
Reston, VA 20190  
Attn: Beth Kinsey  
FAX: (703) 467-9308

The parties hereto may change the address at which they are to receive notices hereunder, by notice in writing in the foregoing manner given to the other.

**11. CHOICE OF LAW AND VENUE; JURY TRIAL WAIVER.**

This Agreement shall be governed by, and construed in accordance with, the internal laws of the State of California, without regard to principles of conflicts of law. Each of Borrower and Bank hereby submits to the exclusive jurisdiction of the state and Federal courts located in the County of Santa Clara, State of California. BORROWERS AND BANK EACH HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF ANY OF THE LOAN DOCUMENTS OR ANY OF THE TRANSACTIONS CONTEMPLATED THEREIN, INCLUDING CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW OR STATUTORY CLAIMS. EACH PARTY RECOGNIZES AND AGREES THAT THE FOREGOING WAIVER CONSTITUTES A MATERIAL INDUCEMENT FOR IT TO ENTER INTO THIS AGREEMENT. EACH PARTY REPRESENTS AND WARRANTS THAT IT HAS REVIEWED THIS WAIVER WITH ITS LEGAL COUNSEL AND THAT IT KNOWINGLY AND VOLUNTARILY WAIVES ITS JURY TRIAL RIGHTS FOLLOWING CONSULTATION WITH LEGAL COUNSEL.

**12. REFERENCE PROVISION.**

12.1 In the event the Jury Trial Waiver set forth above is not enforceable, the parties elect to proceed under this Judicial Reference Provision.

12.2 With the exception of the items specified in clause 12.3, below, any controversy, dispute or claim (each, a "Claim") between the parties arising out of or relating to this Agreement or any other document, instrument or agreement between the undersigned parties (collectively in this Section, the "Comerica Documents"), will be resolved by a reference proceeding in California in accordance with the provisions of Sections 638 et seq. of the California Code of Civil Procedure ("CCP"), or their successor sections, which shall constitute the exclusive remedy for the resolution of any Claim, including whether the Claim is subject to the reference proceeding. Except as otherwise provided in the Comerica Documents, venue for the reference proceeding will be in the state or federal court in the

county or district where the real property involved in the action, if any, is located or in the state or federal court in the county or district where venue is otherwise appropriate under applicable law (the "Court").

12.3 The matters that shall not be subject to a reference are the following: (i) nonjudicial foreclosure of any security interests in real or personal property, (ii) exercise of self-help remedies (including, without limitation, set-off), (iii) appointment of a receiver and (iv) temporary, provisional or ancillary remedies (including, without limitation, writs of attachment, writs of possession, temporary restraining orders or preliminary injunctions). This reference provision does not limit the right of any party to exercise or oppose any of the rights and remedies described in clauses (i) and (ii) or to seek or oppose from a court of competent jurisdiction any of the items described in clauses (iii) and (iv). The exercise of, or opposition to, any of those items does not waive the right of any party to a reference pursuant to this reference provision as provided herein.

12.4 The referee shall be a retired judge or justice selected by mutual written agreement of the parties. If the parties do not agree within ten (10) days of a written request to do so by any party, then, upon request of any party, the referee shall be selected by the Presiding Judge of the Court (or his or her representative). A request for appointment of a referee may be heard on an ex parte or expedited basis, and the parties agree that irreparable harm would result if ex parte relief is not granted. Pursuant to CCP § 170.6, each party shall have one peremptory challenge to the referee selected by the Presiding Judge of the Court (or his or her representative).

12.5 The parties agree that time is of the essence in conducting the reference proceedings. Accordingly, the referee shall be requested, subject to change in the time periods specified herein for good cause shown, to (i) set the matter for a status and trial-setting conference within fifteen (15) days after the date of selection of the referee, (ii) if practicable, try all issues of law or fact within one hundred twenty (120) days after the date of the conference and (iii) report a statement of decision within twenty (20) days after the matter has been submitted for decision.

12.6 The referee will have power to expand or limit the amount and duration of discovery. The referee may set or extend discovery deadlines or cutoffs for good cause, including a party's failure to provide requested discovery for any reason whatsoever. Unless otherwise ordered based upon good cause shown, no party shall be entitled to "priority" in conducting discovery, depositions may be taken by either party upon seven (7) days written notice, and all other discovery shall be responded to within fifteen (15) days after service. All disputes relating to discovery which cannot be resolved by the parties shall be submitted to the referee whose decision shall be final and binding.

12.7 Except as expressly set forth herein, the referee shall determine the manner in which the reference proceeding is conducted including the time and place of hearings, the order of presentation of evidence, and all other questions that arise with respect to the course of the reference proceeding. All proceedings and hearings conducted before the referee, except for trial, shall be conducted without a court reporter, except that when any party so requests, a court reporter will be used at any hearing conducted before the referee, and the referee will be provided a courtesy copy of the transcript. The party making such a request shall have the obligation to arrange for and pay the court reporter. Subject to the referee's power to award costs to the prevailing party, the parties will equally share the cost of the referee and the court reporter at trial.

12.8 The referee shall be required to determine all issues in accordance with existing case law and the statutory laws of the State of California. The rules of evidence applicable to proceedings at law in the State of California will be applicable to the reference proceeding. The referee shall be empowered to enter equitable as well as legal relief, enter equitable orders that will be binding on the parties and rule on any motion which would be authorized in a court proceeding, including without limitation motions for summary judgment or summary adjudication. The referee shall issue a decision at the close of the reference proceeding which disposes of all claims of the parties that are the subject of the reference. Pursuant to CCP § 644, such decision shall be entered by the Court as a judgment or an order in the same manner as if the action had been tried by the Court and any such decision will be final, binding and conclusive. The parties reserve the right to appeal from the final judgment or order or from any appealable decision or order entered by the referee. The parties reserve the right to findings of fact, conclusions of laws, a written statement of decision, and the right to move for a new trial or a different judgment, which new trial, if granted, is also to be a reference proceeding under this provision.

12.9 If the enabling legislation which provides for appointment of a referee is repealed (and no successor statute is enacted), any dispute between the parties that would otherwise be determined by reference procedure will be resolved and determined by arbitration. The arbitration will be conducted by a retired judge or justice, in accordance with the California Arbitration Act §1280 through §1294.2 of the CCP as amended from time to time. The limitations with respect to discovery set forth above shall apply to any such arbitration proceeding.

12.10 THE PARTIES RECOGNIZE AND AGREE THAT ALL CONTROVERSIES, DISPUTES AND CLAIMS RESOLVED UNDER THIS REFERENCE PROVISION WILL BE DECIDED BY A REFEREE AND NOT BY A JURY. AFTER CONSULTING (OR HAVING HAD THE OPPORTUNITY TO CONSULT) WITH COUNSEL OF ITS, HIS OR HER OWN CHOICE, EACH PARTY KNOWINGLY AND VOLUNTARILY, AND FOR THE MUTUAL BENEFIT OF ALL PARTIES, AGREES THAT THIS REFERENCE PROVISION WILL APPLY TO ANY CONTROVERSY, DISPUTE OR CLAIM BETWEEN OR AMONG THEM ARISING OUT OF OR IN ANY WAY RELATED TO, THIS AGREEMENT OR THE OTHER COMERICA DOCUMENTS.

### 13. GENERAL PROVISIONS.

13.1 Successors and Assigns. This Agreement shall bind and inure to the benefit of the respective successors and permitted assigns of each of the parties; provided, however, that neither this Agreement nor any rights hereunder may be assigned by Borrower without Bank's prior written consent, which consent may be granted or withheld in Bank's sole discretion. Bank shall have the right without the consent of or notice to Borrowers to sell, transfer, negotiate, or grant participation in all or any part of, or any interest in, Bank's obligations, rights and benefits hereunder.

13.2 Indemnification. Each Borrower shall defend, indemnify and hold harmless Bank and its officers, employees, and agents against: (a) all obligations, demands, claims, and liabilities claimed or asserted by any other party in connection with the transactions contemplated by this Agreement; and (b) all losses or Bank Expenses in any way suffered, incurred, or paid by Bank as a result of or in any way arising out of, following, or consequential to transactions between Bank and a Borrower whether under this Agreement, or otherwise (including without limitation reasonable attorneys fees and expenses), except for losses caused by Bank's gross negligence or willful misconduct.

13.3 Time of Essence. Time is of the essence for the performance of all obligations set forth in this Agreement.

13.4 Severability of Provisions. Each provision of this Agreement shall be severable from every other provision of this Agreement for the purpose of determining the legal enforceability of any specific provision.

13.5 Amendments in Writing, Integration. Neither this Agreement nor the Loan Documents can be amended or terminated orally. All prior agreements, understandings, representations, warranties, and negotiations between the parties hereto with respect to the subject matter of this Agreement and the Loan Documents, if any, are merged into this Agreement and the Loan Documents.

13.6 Counterparts. This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, shall be deemed to be an original, and all of which, when taken together, shall constitute but one and the same Agreement.

13.7 Survival. All covenants, representations and warranties made in this Agreement shall continue in full force and effect so long as any Obligations remain outstanding or Bank has any obligation to make Credit Extensions to Borrowers. The obligations of each Borrower to indemnify Bank with respect to the expenses, damages, losses, costs and liabilities described in Section 12.2 shall survive until all applicable statute of limitations periods with respect to actions that may be brought against Bank have run.

13.8 Effect of Amendment and Restatement. This Agreement is intended to and does completely amend and restate, without novation, the Original Agreement. All security interests granted under the Original Agreement are hereby confirmed and ratified and shall continue to secure all Obligations under this Agreement.

### 14. CO-BORROWER PROVISIONS.

14.1 Primary Obligation. This Agreement is a primary and original obligation of each Borrower and shall remain in effect notwithstanding future changes in conditions, including any change of law or any invalidity or irregularity in the creation or acquisition of any Obligations or in the execution or delivery of any agreement between Bank and any Borrower. Each Borrower shall be liable for existing and future Obligations as fully as if all of all Credit Extensions were advanced to such Borrower. Bank may rely on any certificate or representation made by any Borrower as made on behalf of, and binding on, all Borrowers, including without limitation Advance Request Forms, Borrowing Base Certificates and Compliance Certificates.

14.2 Enforcement of Rights. Borrowers are jointly and severally liable for the Obligations and Bank may proceed against one or more of the Borrowers to enforce the Obligations without waiving its right to proceed against any of the other Borrowers.

14.3 Borrowers as Agents. Each Borrower appoints the other Borrower as its agent with all necessary power and authority to give and receive notices, certificates or demands for and on behalf of both Borrowers, to act as disbursing agent for receipt of any Advances on behalf of each Borrower and to apply to Bank on behalf of each Borrower for Advances, any waivers and any consents. This authorization cannot be revoked, and Bank need not inquire as to each Borrower's authority to act for or on behalf of Borrower.

14.4 Subrogation and Similar Rights. Notwithstanding any other provision of this Agreement or any other Loan Document, each Borrower irrevocably waives all rights that it may have at law or in equity (including, without limitation, any law subrogating the Borrower to the rights of Bank under the Loan Documents) to seek contribution, indemnification, or any other form of reimbursement from any other Borrower, or any other Person now or hereafter primarily or secondarily liable for any of the Obligations, for any payment made by the Borrower with respect to the Obligations in connection with the Loan Documents or otherwise and all rights that it might have to benefit from, or to participate in, any security for the Obligations as a result of any payment made by the Borrower with respect to the Obligations in connection with the Loan Documents or otherwise. Any agreement providing for indemnification, reimbursement or any other arrangement prohibited under this Section 13.4 shall be null and void. If any payment is made to a Borrower in contravention of this Section 13.4, such Borrower shall hold such payment in trust for Bank and such payment shall be promptly delivered to Bank for application to the Obligations, whether matured or unmatured.

14.5 Waivers of Notice. Except as otherwise provided in this Agreement, each Borrower waives notice of acceptance hereof; notice of the existence, creation or acquisition of any of the Obligations; notice of an Event of Default; notice of the amount of the Obligations outstanding at any time; notice of intent to accelerate; notice of acceleration; notice of any adverse change in the financial condition of any other Borrower or of any other fact that might increase the Borrower's risk; presentment for payment; demand; protest and notice thereof as to any instrument; default; and all other notices and demands to which the Borrower would otherwise be entitled. Each Borrower waives any defense arising from any defense of any other Borrower, or by reason of the cessation from any cause whatsoever of the liability of any other Borrower. Bank's failure at any time to require strict performance by any Borrower of any provision of the Loan Documents shall not waive, alter or diminish any right of Bank thereafter to demand strict compliance and performance therewith. Nothing contained herein shall prevent Bank from foreclosing on the Lien of any deed of trust, mortgage or other security instrument, or exercising any rights available thereunder, and the exercise of any such rights shall not constitute a legal or equitable discharge of any Borrower. Each Borrower also waives any defense arising from any act or omission of Bank that changes the scope of the Borrower's risks hereunder.

14.6 Subrogation Defenses. Each Borrower hereby waives any defense based on impairment or destruction of its subrogation or other rights against any other Borrower and waives all benefits which might otherwise be available to it under California Civil Code Sections 2809, 2810, 2819, 2839, 2845, 2848, 2849, 2850, 2899, and 3433 and California Code of Civil Procedure Sections 580a, 580b, 580d and 726, as those statutory provisions are now in effect and hereafter amended, and under any other similar statutes now and hereafter in effect.

14.7 Right to Settle, Release.

(a) The liability of Borrowers hereunder shall not be diminished by (i) any agreement, understanding or representation that any of the Obligations is or was to be guaranteed by another Person or secured by

other property, or (ii) any release or unenforceability, whether partial or total, of rights, if any, which Bank may now or hereafter have against any other Person, including another Borrower, or property with respect to any of the Obligations.

(b) Without affecting the liability of any Borrower hereunder, Bank may (i) compromise, settle, renew, extend the time for payment, change the manner or terms of payment, discharge the performance of, decline to enforce, or release all or any of the Obligations with respect to a Borrower, (ii) grant other indulgences to a Borrower in respect of the Obligations, (iii) modify in any manner any documents relating to the Obligations with respect to a Borrower, (iv) release, surrender or exchange any deposits or other property securing the Obligations, whether pledged by a Borrower or any other Person, or (v) compromise, settle, renew, or extend the time for payment, discharge the performance of, decline to enforce, or release all or any obligations of any guarantor, endorser or other Person who is now or may hereafter be liable with respect to any of the Obligations.

14.8 Subordination. All indebtedness of a Borrower now or hereafter arising held by another Borrower is subordinated to the Obligations and the Borrower holding the indebtedness shall take all actions reasonably requested by Lender to effect, to enforce and to give notice of such subordination.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first above written.

ALLIANCE CONSULTING GROUP ASSOCIATES,  
INC.

By: /s/ James Dandy

Title: V.P. of Finance

ALLIANCE HOLDINGS, INC.

By: /s/ Jeffrey B. McGroarty

Title: Vice President

COMERICA BANK

By: /s/ Beth Kinsey

Title: Senior Vice President

**DEBTOR: ALLIANCE CONSULTING GROUP ASSOCIATES, INC.  
ALLIANCE HOLDINGS, INC.**

**SECURED PARTY: COMERICA BANK**

EXHIBIT A

COLLATERAL DESCRIPTION ATTACHMENT  
TO LOAN AND SECURITY AGREEMENT

All personal property of Borrower (herein referred to as "Borrower" or "Debtor") whether presently existing or hereafter created or acquired, and wherever located, including, but not limited to:

(a) all accounts (including health-care-insurance receivables), chattel paper (including tangible and electronic chattel paper), deposit accounts, documents (including negotiable documents), equipment (including all accessions and additions thereto), general intangibles (including payment intangibles and software), goods (including fixtures), instruments (including promissory notes), inventory (including all goods held for sale or lease or to be furnished under a contract of service, and including returns and repossessions), investment property (including securities and securities entitlements), letter of credit rights, money, and all of Debtor's books and records with respect to any of the foregoing, and the computers and equipment containing said books and records;

(b) all common law and statutory copyrights and copyright registrations, applications for registration, now existing or hereafter arising, in the United States of America or in any foreign jurisdiction, obtained or to be obtained on or in connection with any of the foregoing, or any parts thereof or any underlying or component elements of any of the foregoing, together with the right to copyright and all rights to renew or extend such copyrights and the right (but not the obligation) of Secured Party to sue in its own name and/or in the name of the Debtor for past, present and future infringements of copyright;

(c) all trademarks, service marks, trade names and service names and the goodwill associated therewith, together with the right to trademark and all rights to renew or extend such trademarks and the right (but not the obligation) of Secured Party to sue in its own name and/or in the name of the Debtor for past, present and future infringements of trademark;

(d) all (i) patents and patent applications filed in the United States Patent and Trademark Office or any similar office of any foreign jurisdiction, and interests under patent license agreements, including, without limitation, the inventions and improvements described and claimed therein, (ii) licenses pertaining to any patent whether Debtor is licensor or licensee, (iii) income, royalties, damages, payments, accounts and accounts receivable now or hereafter due and/or payable under and with respect thereto, including, without limitation, damages and payments for past, present or future infringements thereof, (iv) right (but not the obligation) to sue in the name of Debtor and/or in the name of Secured Party for past, present and future infringements thereof, (v) rights corresponding thereto throughout the world in all jurisdictions in which such patents have been issued or applied for, and (vi) reissues, divisions, continuations, renewals, extensions and continuations-in-part with respect to any of the foregoing; and

(e) any and all cash proceeds and/or noncash proceeds of any of the foregoing, including, without limitation, insurance proceeds, and all supporting obligations and the security therefor or for any right to payment. All terms above have the meanings given to them in the California Uniform Commercial Code, as amended or supplemented from time to time, including revised Division 9 of the Uniform Commercial Code-Secured Transactions, added by Stats. 1999, c.991 (S.B. 45), Section 35, operative July 1, 2001.



**ALLIANCE CONSULTING GROUP ASSOCIATES, INC.  
AND  
ALLIANCE HOLDINGS, INC.  
AMENDED AND RESTATED  
LOAN AND SECURITY AGREEMENT**

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This AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT is entered into as of February 28, 2007 by and among COMERICA BANK ("Bank") and ALLIANCE CONSULTING GROUP ASSOCIATES, INC. and ALLIANCE HOLDINGS, INC. (individually, a "Borrower" and collectively, the "Borrowers").

#### RECITALS

A. Borrowers and Bank are parties to that certain Loan and Security Agreement dated as of September 25, 2003, as amended, including, without limitation, by that certain First Amendment to Loan and Security Agreement dated as of December 12, 2003, that certain Second Amendment to Loan and Security Agreement dated as of May 27, 2004, that certain Third Amendment to Loan Documents dated as of August 9, 2004, that certain Fourth Amendment to Loan Documents dated as of September 30, 2004, that certain Fifth Amendment to Loan Documents dated as of March 11, 2005, that certain Sixth Amendment to Loan Documents dated as of June 30, 2005, that certain Seventh Amendment to Loan Documents dated as of February 28, 2006, that certain Eighth Amendment and Consent to Loan Documents dated as of April 27, 2006, that certain Consent to Loan Documents dated as of July 13, 2006 and that certain Ninth Amendment and Waiver to Loan Documents dated December 29, 2006 (collectively, the "Agreement") and that certain LIBOR Addendum to Loan and Security Agreement dated as of September 25, 2003 (the "LIBOR Addendum")(the Agreement and the LIBOR Addendum, collectively, the "Original Agreement").

B. Borrowers and Bank wish to amend and restate the terms of the Original Agreement and to evidence the obligations of Borrowers to Bank in two separate agreements, one subject to a guaranty and the other not. This Agreement sets forth the terms on which Bank will advance credit to Borrowers in respect of the guaranteed loans, and Borrower will repay the amounts owing to Bank.

#### AGREEMENT

The parties agree as follows:

##### 1. DEFINITIONS AND CONSTRUCTION.

1.1 Definitions. As used in this Agreement, the following terms shall have the following definitions:

"Accounts" means all presently existing and hereafter arising accounts, contract rights, payment intangibles and all other forms of obligations owing to a Borrower arising out of the sale or lease of goods (including, without limitation, the licensing of software and other technology) or the rendering of services by a Borrower, whether or not earned by performance, and any and all credit insurance, guaranties, and other security therefor, as well as all merchandise returned to or reclaimed by Borrower and Borrower's Books relating to any of the foregoing.

"Advance" or "Advances" means a cash advance or cash advances under the Revolving Facility.

"Affiliate" means, with respect to any Person, any Person that owns or controls directly or indirectly such Person, any Person that controls or is controlled by or is under common control with such Person, and each of such Person's senior executive officers, directors, and partners. "Affiliate" does not include any partner companies of Safeguard Scientifics, Inc. or either Guarantor.

"Bank Expenses" means all reasonable costs or expenses (including reasonable attorneys' fees and expenses) incurred in connection with the preparation, negotiation, administration, and enforcement of the Loan Documents; reasonable Collateral audit fees; and Bank's reasonable attorneys' fees and expenses incurred in amending, enforcing or defending the Loan Documents (including fees and expenses of appeal), incurred before, during and after an Insolvency Proceeding, whether or not suit is brought.

"Borrower's Books" means all of a Borrower's books and records including: ledgers; records concerning Borrower's assets or liabilities, the Collateral, business operations or financial condition; and all computer programs, or tape files, and the equipment, containing such information.

“Business Day” means any day that is not a Saturday, Sunday, or other day on which banks in the State of California or the Commonwealth of Pennsylvania are authorized or required to close.

“Change in Control” means (a) a sale of all or substantially all of the assets of a Borrower, or (b) a transaction in which any “person” or “group” (within the meaning of Section 13(d) and 14(d)(2) of the Securities Exchange Act of 1934) becomes the “beneficial owner” (as defined in Rule 13d-3 under the Securities Exchange Act of 1934), directly or indirectly, of a sufficient number of shares of all classes of stock then outstanding of a Borrower ordinarily entitled to vote in the election of directors, empowering such “person” or “group” to elect a majority of the Board of Directors of a Borrower, who did not have such power before such transaction; provided that a transaction with any Affiliate of a Borrower shall not constitute a “Change of Control.”

“Closing Date” means the date of this Agreement.

“Code” means the California Uniform Commercial Code.

“Collateral” means the property described on Exhibit A attached hereto.

“Contingent Obligation” means, as applied to any Person, any direct or indirect liability, contingent or otherwise, of that Person with respect to (i) any indebtedness, lease, dividend, letter of credit or other obligation of another, including, without limitation, any such obligation directly or indirectly guaranteed, endorsed, co-made or discounted or sold with recourse by that Person, or in respect of which that Person is otherwise directly or indirectly liable; (ii) any obligations with respect to undrawn letters of credit, corporate credit cards, or merchant services issued or provided for the account of that Person; and (iii) all obligations arising under any interest rate, currency or commodity swap agreement, interest rate cap agreement, interest rate collar agreement, or other agreement or arrangement designed to protect a Person against fluctuation in interest rates, currency exchange rates or commodity prices; provided, however, that the term “Contingent Obligation” shall not include endorsements for collection or deposit in the ordinary course of business. The amount of any Contingent Obligation shall be deemed to be an amount equal to the stated or determined amount of the primary obligation in respect of which such Contingent Obligation is made or, if not stated or determinable, the maximum reasonably anticipated liability in respect thereof as determined by such Person in good faith; provided, however, that such amount shall not in any event exceed the maximum amount of the obligations under the guarantee or other support arrangement.

“Copyrights” means any and all copyright rights, copyright applications, copyright registrations and like protections in each work or authorship and derivative work thereof, whether published or unpublished and whether or not the same also constitutes a trade secret, now or hereafter existing, created, acquired or held.

“Credit Extension” means each Advance, or any other extension of credit by Bank for the benefit of Borrower hereunder.

“Current Assets” means, as of any applicable date, all amounts that should, in accordance with GAAP, be included as current assets on the consolidated balance sheet of Borrower and its Subsidiaries, as at such date.

“Current Liabilities” means, as of any applicable date, all amounts that should, in accordance with GAAP, be included as current liabilities on the consolidated balance sheet of Borrower and its Subsidiaries, as at such date, plus, to the extent not already included therein, all outstanding Credit Extensions made under this Agreement, including all Indebtedness that is payable upon demand or within one year from the date of determination thereof unless such Indebtedness is renewable or extendible at the option of Borrower or any Subsidiary to a date more than one year from the date of determination.

“Daily Balance” means the amount of the Obligations owed at the end of a given day.

“Equipment” means all present and future machinery, equipment, tenant improvements, furniture, fixtures, vehicles, tools, parts and attachments in which Borrower has any interest.

“ERISA” means the Employee Retirement Income Security Act of 1974, as amended, and the regulations thereunder.

“Event of Default” has the meaning assigned in Article 8.

“Formula Loan Agreement” means the Loan and Security Agreement of even date between Borrowers and Bank.

“GAAP” means generally accepted accounting principles as in effect from time to time.

“Guarantor” means Safeguard Delaware, Inc. and Safeguard Scientifics Delaware, Inc.

“Indebtedness” means (a) all indebtedness for borrowed money or the deferred purchase price of property or services, including without limitation reimbursement and other obligations with respect to surety bonds and letters of credit, (b) all obligations evidenced by notes, bonds, debentures or similar instruments, (c) all capital lease obligations and (d) all Contingent Obligations.

“Insolvency Proceeding” means any proceeding commenced by or against any person or entity under any provision of the United States Bankruptcy Code, as amended, or under any other bankruptcy or insolvency law, including assignments for the benefit of creditors, formal or informal moratoria, compositions, extension generally with its creditors, or proceedings seeking reorganization, arrangement, or other relief.

“Intellectual Property Collateral” means all of a Borrower’s right, title, and interest in and to the following:

(a) Copyrights, Trademarks and Patents;

(b) Any and all trade secrets, and any and all intellectual property rights in computer software and computer software products now or hereafter existing, created, acquired or held;

(c) Any and all design rights which may be available to a Borrower now or hereafter existing, created, acquired or held;

(d) Any and all claims for damages by way of past, present and future infringement of any of the rights included above, with the right, but not the obligation, to sue for and collect such damages for said use or infringement of the intellectual property rights identified above;

(e) All licenses or other rights to use any of the Copyrights, Patents or Trademarks, and all license fees and royalties arising from such use to the extent permitted by such license or rights;

(f) All amendments, renewals and extensions of any of the Copyrights, Trademarks or Patents; and

(g) All proceeds and products of the foregoing, including without limitation all payments under insurance or any indemnity or warranty payable in respect of any of the foregoing;

provided however, that any of the foregoing developed by a Borrower to be used exclusively by a Borrower’s customer shall not constitute “Intellectual Property Collateral”.

“Inventory” means all present and future inventory in which Borrower has any interest, including merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products intended for sale or lease or to be furnished under a contract of service, of every kind and description now or at any time hereafter owned by or in the custody or possession, actual or constructive, of Borrower, including such inventory as is temporarily out of its custody or possession or in transit and including any returns upon any accounts or

other proceeds, including insurance proceeds, resulting from the sale or disposition of any of the foregoing and any documents of title representing any of the above, and Borrower's Books relating to any of the foregoing.

"Investment" means any beneficial ownership of (including stock, partnership interest or other securities) any Person, or any loan, advance or capital contribution to any Person.

"IRC" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

"Lien" means any mortgage, lien, deed of trust, charge, pledge, security interest or other encumbrance.

"Loan Documents" means, collectively, this Agreement, any note or notes executed by Borrower, and any other agreement entered into in connection with this Agreement, all as amended or extended from time to time.

"Material Adverse Effect" means a material adverse effect on (i) the business operations condition (financial or otherwise) or prospects of a Borrower and its Subsidiaries taken as a whole, (ii) the ability of a Borrower to repay the Obligations or otherwise perform its obligations under the Loan Documents, or (iii) the value or priority of Bank's security interests in the Collateral.

"Negotiable Collateral" means all of Borrower's present and future letters of credit of which it is a beneficiary, notes, drafts, instruments, securities, documents of title, and chattel paper, and Borrower's Books relating to any of the foregoing.

"Obligations" means all debt, principal, interest, Bank Expenses and other amounts owed to Bank by Borrower pursuant to this Agreement or any other agreement, whether absolute or contingent, due or to become due, now existing or hereafter arising, including any interest that accrues after the commencement of an Insolvency Proceeding.

"Patents" means all patents, patent applications and like protections including without limitation improvements, divisions, continuations, renewals, reissues, extensions and continuations in part of the same.

"Periodic Payments" means all installments or similar recurring payments that a Borrower may now or hereafter become obligated to pay to Bank pursuant to the terms and provisions of any instrument, or agreement now or hereafter in existence between a Borrower and Bank.

"Permitted Indebtedness" means:

(h) Indebtedness of a Borrower in favor of Bank arising under this Agreement, the Formula Loan Agreement, or any other Loan Document;

(i) Indebtedness existing on the Closing Date and disclosed in the Schedule;

(j) Indebtedness secured by a lien described in clause (c) of the defined term "Permitted Liens," provided (i) such Indebtedness does not exceed the lesser of the cost or fair market value of the equipment financed with such Indebtedness and (ii) such Indebtedness does not exceed \$250,000 in the aggregate at any given time; and

(k) Subordinated Debt.

"Permitted Investment" means:

(a) Investments existing on the Closing Date disclosed in the Schedule; and

(b) (i) marketable direct obligations issued or unconditionally guaranteed by the United States of America or any agency or any State thereof maturing within one (1) year from the date of acquisition thereof, (ii) commercial paper maturing no more than one (1) year from the date of creation thereof and currently having rating of at least A-2 or P-2 from either Standard & Poor's Corporation or Moody's Investors Service, (iii) certificates of deposit maturing no more than one (1) year from the date of investment therein issued by Bank, and (iv) Bank's money market accounts.

"Permitted Liens" means the following:

(a) Any Liens existing on the Closing Date and disclosed in the Schedule or arising under this Agreement or the other Loan Documents;

(b) Liens for taxes, fees, assessments or other governmental charges or levies, either not delinquent or being contested in good faith by appropriate proceedings, provided the same have no priority over any of Bank's security interests;

(c) Liens (i) upon or in any equipment which was not financed by Bank acquired or held by a Borrower or any of its Subsidiaries to secure the purchase price of such equipment or indebtedness incurred solely for the purpose of financing the acquisition of such equipment, or (ii) existing on such equipment at the time of its acquisition, provided that the Lien is confined solely to the property so acquired and improvements thereon, and the proceeds of such equipment; and

(d) Liens incurred in connection with the extension, renewal or refinancing of the indebtedness secured by Liens of the type described in clauses (a) through (c) above, provided that any extension, renewal or replacement Lien shall be limited to the property encumbered by the existing Lien and the principal amount of the indebtedness being extended, renewed or refinanced does not increase.

"Person" means any individual, sole proprietorship, partnership, limited liability company, joint venture, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or governmental agency.

"Prime Rate" means the variable rate of interest, per annum, most recently announced by Bank, as its "prime rate," whether or not such announced rate is the lowest rate available from Bank.

"Responsible Officer" means each of the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer, Vice President of Finance and the Controller of Borrower.

"Revolving Facility" means the facility under which Borrowers may request Bank to issue Advances, as specified in Section 2.1(a) hereof.

"Revolving Line" means a credit extension of up to Five Million Dollars (\$5,000,000).

"Revolving Maturity Date" means February 27, 2008.

"Schedule" means the schedule of exceptions attached hereto and approved by Bank, if any.

"Subordinated Debt" means any debt incurred by a Borrower that is subordinated to the debt owing by Borrower to Bank on terms acceptable to Bank (and identified as being such by Borrower and Bank).

"Subsidiary" means any corporation, company or partnership in which (i) any general partnership interest or (ii) more than 50% of the stock or other units of ownership which by the terms thereof has the ordinary voting power to elect the Board of Directors, managers or trustees of the entity, at the time as of which any determination is being made, is owned by a Borrower, either directly or through an Affiliate.

“Trademarks” means any trademark and servicemark rights, whether registered or not, applications to register and registrations of the same and like protections, and the entire goodwill of the business of a Borrower connected with and symbolized by such trademarks.

1.2 Accounting Terms. All accounting terms not specifically defined herein shall be construed in accordance with GAAP and all calculations made hereunder shall be made in accordance with GAAP. When used herein, the terms “financial statements” shall include the notes and schedules thereto.

## 2. LOAN AND TERMS OF PAYMENT.

### 2.1 Credit Extensions.

Borrowers promise to pay to the order of Bank, in lawful money of the United States of America, the aggregate unpaid principal amount of all Credit Extensions made by Bank to each Borrower and/or Borrowers hereunder. Borrowers shall also pay interest on the unpaid principal amount of such Credit Extensions at rates in accordance with the terms hereof.

#### (a) Revolving Advances.

(i) **Advances**. Subject to and upon the terms and conditions of this Agreement, Borrowers may request Advances in an aggregate outstanding amount not to exceed the Revolving Line. Subject to the terms and conditions of this Agreement, amounts borrowed pursuant to this Section 2.1(a) may be repaid and reborrowed at any time prior to the Revolving Maturity Date, at which time all Advances under this Section 2.1(a) shall be immediately due and payable. Borrowers may prepay any Advances without penalty or premium.

(ii) **Procedure**. Whenever Borrowers desire an Advance, a Borrower will notify Bank by facsimile transmission or telephone no later than 3:30 p.m. Eastern time, on the Business Day that the Advance is to be made. Each such notification shall be promptly confirmed by a Payment/Advance Form in substantially the form of Exhibit B hereto. Bank is authorized to make Advances under this Agreement, based upon instructions received from a Responsible Officer or a designee of a Responsible Officer, or without instructions if in Bank’s discretion such Advances are necessary to meet Obligations which have become due and remain unpaid. Bank shall be entitled to rely on any telephonic notice given by a person who Bank reasonably believes to be a Responsible Officer or a designee thereof, and Borrower shall indemnify and hold Bank harmless for any damages or loss suffered by Bank as a result of such reliance. Bank will credit the amount of Advances made under this Section 2.1(a) to a Borrower’s deposit account.

### 2.2 **Reserved**

### 2.3 Interest Rates, Payments, and Calculations.

(a) Interest Rates. Except as set forth in Section 2.3(b), the Advances shall bear interest, on the outstanding daily balance thereof, at a variable rate equal to the Prime Rate minus 0.5%.

(b) Default Rate. If any payment is not made within ten (10) days after the date such payment is due, Borrowers shall pay Bank a late fee equal to the lesser of (i) five percent (5%) of the amount of such unpaid amount or (ii) the maximum amount permitted to be charged under applicable law. All Obligations shall bear interest, from and after the occurrence and during the continuance of an Event of Default, at a rate equal to five (5) percentage points above the interest rate applicable immediately prior to the occurrence of the Event of Default.

(c) Payments. Interest hereunder shall be due and payable on the first calendar day of each month during the term hereof. Bank shall, at its option, charge such interest, all Bank Expenses, and all Periodic Payments against any of a Borrower’s deposit accounts or against the Revolving Line, in which case those amounts shall thereafter accrue interest at the rate then applicable hereunder. Any interest not paid when due shall be compounded by becoming a part of the Obligations, and such interest shall thereafter accrue interest at the rate then applicable hereunder.

All payments shall be free and clear of any taxes, withholdings, duties, impositions or other charges, to the end that Bank will receive the entire amount of any Obligations payable hereunder, regardless of source of payment.

(d) Computation. In the event the Prime Rate is changed from time to time hereafter, the applicable rate of interest hereunder shall be increased or decreased effective as of the day the Prime Rate is changed, by an amount equal to such change in the Prime Rate. All interest chargeable under the Loan Documents shall be computed on the basis of a three hundred sixty (360) day year for the actual number of days elapsed.

2.4 Crediting Payments. Prior to the occurrence of an Event of Default, Bank shall credit a wire transfer of funds, check or other item of payment to such deposit account or Obligation as Borrowers specify. After the acceleration of the Obligations and so long as the Obligations remain unpaid, the receipt by Bank of any wire transfer of funds, check, or other item of payment shall be immediately applied to conditionally reduce Obligations, but shall not be considered a payment on account unless such payment is of immediately available federal funds or unless and until such check or other item of payment is honored when presented for payment. Notwithstanding anything to the contrary contained herein, any wire transfer or payment received by Bank after 3:30 p.m. Eastern time shall be deemed to have been received by Bank as of the opening of business on the immediately following Business Day. Whenever any payment to Bank under the Loan Documents would otherwise be due (except by reason of acceleration) on a date that is not a Business Day, such payment shall instead be due on the next Business Day, and additional fees or interest, as the case may be, shall accrue and be payable for the period of such extension.

2.5 Fees. Borrowers shall pay to Bank the following:

(a) Facility Fee. None;

(b) Commitment Fee. None; and

(c) Bank Expenses. (i) On the Closing Date, all Bank Expenses incurred through the Closing Date, including reasonable attorneys' fees, and (ii) after the Closing Date, all Bank Expenses, including reasonable attorneys' fees and expenses, as and when they are billed by Bank to the Borrowers, with appropriate supporting evidence and backup information to the extent available.

2.6 Term. This Agreement shall become effective on the Closing Date and, subject to Section 13.7, shall continue in full force and effect for so long as any Obligations remain outstanding or Bank has any obligation to make Credit Extensions under this Agreement. Notwithstanding the foregoing, Bank shall have the right to terminate its obligation to make Credit Extensions under this Agreement immediately and without notice upon the occurrence and during the continuance of an Event of Default. Notwithstanding termination, Bank's Lien on the Collateral shall remain in effect for so long as any Obligations are outstanding.

### 3. CONDITIONS OF LOANS.

3.1 Conditions Precedent to Initial Credit Extension. The obligation of Bank to make the initial Credit Extension is subject to the condition precedent that Bank shall have received, in form and substance satisfactory to Bank, the following:

(a) this Agreement;

(b) a certificate of the Secretary of each Borrower with respect to incumbency and resolutions authorizing the execution and delivery of this Agreement;

(c) financing statements (Form UCC-1);

(d) a subordination agreement;

(e) an Affirmation of Guaranty ;

- (f) payment of the fees and Bank Expenses then due specified in Section 2.5 hereof;
- (g) current financial statements of Borrowers for the most recent fiscal quarter; and
- (h) such other documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.

3.2 Conditions Precedent to all Credit Extensions. The obligation of Bank to make each Credit Extension, including the initial Credit Extension, is further subject to the following conditions:

(a) timely receipt by Bank of the Payment/Advance Form as provided in Section 2.1; and

(b) the representations and warranties contained in Section 5 shall be true and correct in all material respects on and as of the date of such Payment/Advance Form and on the effective date of each Credit Extension as though made at and as of each such date, and no Event of Default shall have occurred and be continuing, or would exist after giving effect to such Credit Extension (provided, however, that those representations and warranties expressly referring to another date shall be true, correct and complete in all material respects as of such date). The making of each Credit Extension shall be deemed to be a representation and warranty by Borrower on the date of such Credit Extension as to the accuracy of the facts referred to in this Section 3.2.

#### 4. CREATION OF SECURITY INTEREST.

4.1 Grant of Security Interest. Each Borrower hereby grants and pledges to Bank a continuing security interest in all presently existing and hereafter acquired or arising Collateral in order to secure prompt repayment of any and all Obligations and in order to secure prompt performance by Borrower of each of its covenants and duties under the Loan Documents. Except as set forth in the Schedule, such security interest constitutes a valid, first priority security interest in the presently existing Collateral, and will constitute a valid, first priority security interest in Collateral acquired after the date hereof.

4.2 Delivery of Additional Documentation Required. Each Borrower shall from time to time execute and deliver to Bank, at the request of Bank, all Negotiable Collateral, all financing statements and other documents that Bank may reasonably request, in form satisfactory to Bank, to perfect and continue the perfection of Bank's security interests in the Collateral and in order to fully consummate all of the transactions contemplated under the Loan Documents. Borrowers from time to time may deposit with Bank specific time deposit accounts to secure specific Obligations. Borrowers authorize Bank to hold such balances in pledge and to decline to honor any drafts thereon or any request by a Borrower or any other Person to pay or otherwise transfer any part of such balances for so long as the Obligations are outstanding.

4.3 Right to Inspect. Bank (through any of its officers, employees, or agents) shall have the right, upon reasonable prior notice, from time to time during Borrower's usual business hours, but no more than twice a year (unless an Event of Default has occurred and is continuing), to inspect Borrower's Books and to make copies thereof and to check, test, and appraise the Collateral in order to verify a Borrower's financial condition or the amount, condition of, or any other matter relating to, the Collateral.

#### 5. REPRESENTATIONS AND WARRANTIES.

Each Borrower represents and warrants as follows:

5.1 Due Organization and Qualification. Each of Borrower and each Subsidiary is a corporation duly existing under the laws of its state of incorporation and qualified and licensed to do business in any state in which the conduct of its business or its ownership of property requires that it be so qualified.

5.2 Due Authorization; No Conflict. The execution, delivery, and performance of the Loan Documents are within Borrower's powers, have been duly authorized, and are not in conflict with nor constitute a breach

of any provision contained in Borrower's Articles of Incorporation or Bylaws, nor will they constitute an event of default under any material agreement to which Borrower is a party or by which Borrower is bound. Except as disclosed in the Schedule, Borrower is not in default under any material agreement to which it is a party or by which it is bound.

5.3 No Prior Encumbrances . Borrower has good and marketable title to its property, free and clear of Liens, except for Permitted Liens.

5.4 Bona Fide Accounts . The Accounts are bona fide existing obligations. The property and services giving rise to such Accounts has been delivered or rendered to the account debtor or to the account debtor's agent for immediate and unconditional acceptance by the account debtor. .

5.5 Merchantable Inventory . All Inventory is in all material respects of good and marketable quality, free from all material defects, except for Inventory for which adequate reserves have been made.

5.6 Intellectual Property Collateral . Borrower is the sole owner of the Intellectual Property Collateral, except for non-exclusive licenses granted by Borrower to its customers in the ordinary course of business. Each of the Patents is valid and enforceable, and no part of the Intellectual Property Collateral has been judged invalid or unenforceable, in whole or in part, and no claim has been made that any part of the Intellectual Property Collateral violates the rights of any third party. Except as set forth in the Schedule, Borrower's rights as a licensee of intellectual property do not give rise to more than five percent (5%) of its gross revenue in any given month, including without limitation revenue derived from the sale, licensing, rendering or disposition of any product or service. Except as set forth in the Schedule, Borrower is not a party to, or bound by, any agreement that restricts the grant by Borrower of a security interest in Borrower's rights under such agreement.

5.7 Name; Location of Chief Executive Office . Except as disclosed in the Schedule, Borrower has not done business under any name other than that specified on the signature page hereof. The chief executive office of Borrower is located at the address indicated in Section 10 hereof.

5.8 Litigation . Except as set forth in the Schedule, there are no actions or proceedings pending by or against Borrower or any Subsidiary before any court or administrative agency in which an adverse decision could have a Material Adverse Effect or a material adverse effect on Borrower's interest or Bank's security interest in the Collateral.

5.9 No Material Adverse Change in Financial Statements . All consolidated and consolidating financial statements related to Borrower and any Subsidiary that Bank has received from Borrower fairly present in all material respects Borrower's financial condition as of the date thereof and Borrower's consolidated and consolidating results of operations for the period then ended. There has not been a material adverse change in the consolidated or the consolidating financial condition of Borrower since the date of the most recent of such financial statements submitted to Bank.

5.10 Solvency, Payment of Debts . Except as disclosed in the Schedule, Borrower is solvent and able to pay its debts (including trade debts) as they mature.

5.11 Regulatory Compliance . Borrower and each Subsidiary has met the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA, and no event has occurred resulting from Borrower's failure to comply with ERISA that could result in Borrower's incurring any material liability. Borrower is not an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940. Borrower is not engaged principally, or as one of the important activities, in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulations T and U of the Board of Governors of the Federal Reserve System). Borrower has complied with all the provisions of the Federal Fair Labor Standards Act. Borrower has not violated any statutes, laws, ordinances or rules applicable to it, violation of which could have a Material Adverse Effect.

5.12 Environmental Condition . Except as disclosed in the Schedule, none of Borrower's or any Subsidiary's properties or assets has ever been used by Borrower or any Subsidiary or, to the best of Borrower's

knowledge, by previous owners or operators, in the disposal of, or to produce, store, handle, treat, release, or transport, any hazardous waste or hazardous substance other than in accordance with applicable law; to the best of Borrower's knowledge, none of Borrower's properties or assets has ever been designated or identified in any manner pursuant to any environmental protection statute as a hazardous waste or hazardous substance disposal site, or a candidate for closure pursuant to any environmental protection statute; no lien arising under any environmental protection statute has attached to any revenues or to any real or personal property owned by Borrower or any Subsidiary; and neither Borrower nor any Subsidiary has received a summons, citation, notice, or directive from the Environmental Protection Agency or any other federal, state or other governmental agency concerning any action or omission by Borrower or any Subsidiary resulting in the releasing, or otherwise disposing of hazardous waste or hazardous substances into the environment.

5.13 Taxes. Except as disclosed in the Schedule, Borrower and each Subsidiary has filed or caused to be filed all tax returns required to be filed, and has paid, or has made adequate provision for the payment of, all taxes reflected therein.

5.14 Subsidiaries. Borrower does not own any stock, partnership interest or other equity securities of any Person, except for Permitted Investments.

5.15 Government Consents. Borrower and each Subsidiary has obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all governmental authorities that are necessary for the continued operation of Borrower's business as currently conducted, the failure to obtain which could have a Material Adverse Effect.

5.16 Accounts. None of Borrower's property is maintained or invested with a Person other than Bank. None of any Subsidiary's property within the United States is maintained or invested with a Person other than Bank.

5.17 Full Disclosure. No representation, warranty or other statement made by Borrower in any certificate or written statement furnished to Bank contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements contained in such certificates or statements not misleading.

## 6. AFFIRMATIVE COVENANTS.

Each Borrower covenants and agrees that, until payment in full of all outstanding Obligations, and for so long as Bank may have any commitment to make a Credit Extension hereunder, each Borrower shall do all of the following:

6.1 Good Standing. Borrower shall maintain its and each of its Subsidiaries' corporate existence and good standing in its jurisdiction of incorporation and maintain qualification in each jurisdiction in which it is required under applicable law. Borrower shall maintain, and shall cause each of its Subsidiaries to maintain, in force all licenses, approvals and agreements, the loss of which could have a Material Adverse Effect.

6.2 Government Compliance. Borrower shall meet, and shall cause each Subsidiary to meet, the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA. Borrower shall comply, and shall cause each Subsidiary to comply, with all statutes, laws, ordinances and government rules and regulations to which it is subject, noncompliance with which could have a Material Adverse Effect.

6.3 Financial Statements, Reports, Certificates. Each Borrower shall deliver the following to Bank: (a) as soon as available, but in any event within thirty (30) days after the end of each calendar month, a company prepared consolidated balance sheet, income, and cash flow statement covering Borrower's consolidated operations during such period, prepared in accordance with GAAP, consistently applied, in a form acceptable to Bank and certified by a Responsible Officer; (b) as soon as available, but in any event within ninety (90) days after the end of Borrower's fiscal year, audited consolidated financial statements of Borrower prepared in accordance with GAAP, consistently applied, together with an unqualified opinion on such financial statements of an independent certified public accounting firm reasonably acceptable to Bank; (c) as soon as available, but in any event within forty-five (45) days after the end of each fiscal quarter and each fiscal year, consolidating financial statements of Alliance Holdings, Inc. prepared in

accordance with GAAP, consistently applied, in a form acceptable to Bank; (d) copies of all quarterly and annual statements, reports and material notices sent or made available generally by Borrower to its security holders or to any holders of Subordinated Debt and, if applicable, all reports on Forms 10-K and 10-Q filed with the Securities and Exchange Commission; (e) promptly upon receipt of notice thereof, a report of any legal actions pending or threatened against Borrower or any Subsidiary that could result in damages or costs to Borrower or any Subsidiary of \$100,000 or more; (f) such budgets, sales projections, operating plans or other financial information as Bank may reasonably request from time to time; and (g) within thirty (30) days after the last day of each fiscal quarter, a report signed by Borrower, in form reasonably acceptable to Bank, listing any applications or registrations that Borrower has made or filed in respect of any Patents, Copyrights or Trademarks and the status of any outstanding applications or registrations, as well as any material change in Borrower's intellectual property, including but not limited to any subsequent ownership right of Borrower in or to any Trademark, Patent or Copyright not specified in Exhibits A, B, and C of the Intellectual Property Security Agreement delivered to Bank by Borrower in connection with this Agreement.

Borrower shall deliver to Bank with the monthly financial statements a Compliance Certificate signed by a Responsible Officer in substantially the form of Exhibit D hereto.

Bank shall have a right from time to time hereafter to audit Borrower's Accounts and appraise Collateral at Borrower's expense, provided that such audits will be conducted no more often than every six (6) months unless an Event of Default has occurred and is continuing and the fees for such audits shall be reasonable and customary for a transaction of this type.

**6.4 Inventory; Returns.** Borrower shall keep all Inventory in good and marketable condition, free from all material defects except for Inventory for which adequate reserves have been made. Returns and allowances, if any, as between Borrower and its account debtors shall be on the same basis and in accordance with the usual customary practices of Borrower, as they exist at the time of the execution and delivery of this Agreement. Borrower shall promptly notify Bank of all returns and recoveries and of all disputes and claims, where the return, recovery, dispute or claim involves more than \$100,000.

**6.5 Taxes.** Except as disclosed in the Schedule, Borrower shall make, and shall cause each Subsidiary to make, due and timely payment or deposit of all material federal, state, and local taxes, assessments, or contributions required of it by law, and will execute and deliver to Bank, on demand, appropriate certificates attesting to the payment or deposit thereof; and Borrower will make, and will cause each Subsidiary to make, timely payment or deposit of all material tax payments and withholding taxes required of it by applicable laws, including, but not limited to, those laws concerning F.I.C.A., F.U.T.A., state disability, and local, state, and federal income taxes, and will, upon request, furnish Bank with proof satisfactory to Bank indicating that Borrower or a Subsidiary has made such payments or deposits; provided that Borrower or a Subsidiary need not make any payment if the amount or validity of such payment is contested in good faith by appropriate proceedings and is reserved against (to the extent required by GAAP) by Borrower.

#### **6.6 Insurance.**

(a) Borrower, at its expense, shall keep the Collateral insured against loss or damage by fire, theft, explosion, sprinklers, and all other hazards and risks, and in such amounts, as ordinarily insured against by other owners in similar businesses conducted in the locations where Borrower's business is conducted on the date hereof. Borrower shall also maintain insurance relating to Borrower's business, ownership and use of the Collateral in amounts and of a type that are customary to businesses similar to Borrower's.

(b) All such policies of insurance shall be in such form, with such companies, and in such amounts as are reasonably satisfactory to Bank. All such policies of property insurance shall contain a lender's loss payable endorsement, in a form satisfactory to Bank, showing Bank as an additional loss payee thereof, and all liability insurance policies shall show the Bank as an additional insured and shall specify that the insurer must give at least twenty (20) days notice to Bank before canceling its policy for any reason. Upon Bank's request, Borrower shall deliver to Bank certified copies of such policies of insurance and evidence of the payments of all premiums therefor. All proceeds payable under any such policy shall, at the option of Bank, be payable to Bank to be applied on account of the Obligations.

6.7 Accounts. Borrower shall maintain and shall cause each of its Subsidiaries to maintain its domestic depository, operating, and investment accounts with Bank and/or its Affiliates.

6.8 Profitability. Beginning February 28, 2007, as of the last day of each month, Borrowers on a consolidated basis shall maintain pre-tax profit as indicated for the three months immediately preceding each date of measurement:

<u>Period measured</u>	<u>Pre-tax profit</u>
Closing Date through 06/30/2007	(\$ 700,000)
7/1/2007 through 8/31/2007	\$ 1.00
9/1/2007 through 12/30/2007	\$ 500,000
12/31/2007 and thereafter	\$1,000,000

6.9 Current Ratio. Borrowers shall maintain at all times, on a consolidated basis, measured as of the last day of each calendar month, a ratio of Current Assets to Current Liabilities plus, to the extent not already included therein, all Indebtedness (including without limitation any Contingent Obligations) owing from Borrower to Bank, less deferred revenue, of at least 0.90 to 1.00 through October 31, 2007, and 1.00 to 1.00 thereafter.

6.10 Consultant Utilization. Borrowers' Consultant Utilization (salaried and hourly) shall be equal to or greater than 75% at all times. As used herein, "Consultant Utilization" means (a) all hours billed by Borrower to a client for consulting work divided by (b) all hours paid by Borrower to an hourly consultant or worked by Borrower's salaried employees which perform consulting services.

6.11 Intellectual Property Rights.

(a) Borrower shall register or cause to be registered (to the extent not already registered) with the United States Patent and Trademark Office or the United States Copyright Office, as the case may be, those registerable intellectual property rights now owned or hereafter developed or acquired by Borrower, to the extent that Borrower, in its reasonable business judgment, deems it appropriate to so protect such intellectual property rights.

(b) Borrower shall promptly give Bank written notice of any applications or registrations of intellectual property rights filed with the United States Patent and Trademark Office, including the date of such filing and the registration or application numbers, if any. Borrower shall (i) give Bank not less than 30 days prior written notice of the filing of any applications or registrations with the United States Copyright Office, including the title of such intellectual property rights to be registered, as such title will appear on such applications or registrations, and the date such applications or registrations will be filed, and (ii) prior to the filing of any such applications or registrations, shall execute such documents as Bank may reasonably request for Bank to maintain its perfection in such intellectual property rights to be registered by Borrower, and upon the request of Bank, shall file such documents simultaneously with the filing of any such applications or registrations. Upon filing any such applications or registrations with the United States Copyright Office, Borrower shall promptly provide Bank with (i) a copy of such applications or registrations, without the exhibits, if any, thereto, (ii) evidence of the filing of any documents requested by Bank to be filed for Bank to maintain the perfection and priority of its security interest in such intellectual property rights, and (iii) the date of such filing.

(c) Borrower shall execute and deliver such additional instruments and documents from time to time as Bank shall reasonably request to perfect and maintain the priority of Bank's security interest in the Intellectual Property Collateral. Borrower shall (i) protect, defend and maintain the validity and enforceability of the trade secrets, Trademarks, Patents and Copyrights, (ii) use commercially reasonable efforts to detect infringements of the Trademarks, Patents and Copyrights and promptly advise Bank in writing of material infringements detected and (iii) not allow any material Trademarks, Patents or Copyrights to be abandoned, forfeited or dedicated to the public without the written consent of Bank, which shall not be unreasonably withheld.

(d) Bank may audit Borrower's Intellectual Property Collateral to confirm compliance with this Section, provided such audit may not occur more often than twice per year, unless an Event of Default has occurred and is continuing. Bank shall have the right, but not the obligation, to take, at Borrower's sole expense, any actions that Borrower is required under this Section to take but which Borrower fails to take, after 15 days' notice to Borrower. Borrower shall reimburse and indemnify Bank for all reasonable costs and reasonable expenses incurred in the reasonable exercise of its rights under this Section.

6.12 Further Assurances. At any time and from time to time Borrower shall execute and deliver such further instruments and take such further action as may reasonably be requested by Bank to effect the purposes of this Agreement.

## 7. NEGATIVE COVENANTS.

Each Borrower covenants and agrees that, so long as any credit hereunder shall be available and until payment in full of the outstanding Obligations or for so long as Bank may have any commitment to make any Credit Extensions, no Borrower will do any of the following:

7.1 Dispositions. Without Bank's prior written consent, which shall not be unreasonably withheld, except as disclosed in the Schedule, convey, sell, lease, transfer or otherwise dispose of (collectively, a "Transfer"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property, other than: (i) Transfers of Inventory in the ordinary course of business; (ii) Transfers of non-exclusive licenses and similar arrangements for the use of the property of Borrower or its Subsidiaries in the ordinary course of business; or (iii) Transfers of worn-out or obsolete Equipment.

7.2 Change in Business; Change in Control or Executive Office. Without Bank's prior written consent, which shall not be unreasonably withheld, engage in any business, or permit any of its Subsidiaries to engage in any business, other than the businesses currently engaged in by Borrower and any business substantially similar or related thereto (or incidental thereto); or cease to conduct business in the manner conducted by Borrower as of the Closing Date; or suffer or permit a Change in Control; or without thirty (30) days prior written notification to Bank, relocate its chief executive office or state of incorporation or change its legal name; or without Bank's prior written consent, change the date on which its fiscal year ends.

7.3 Mergers or Acquisitions. Without Bank's prior written consent, which shall not be unreasonably withheld, merge or consolidate; or permit any of its Subsidiaries to merge or consolidate, with or into any other business organization (other than any Affiliate of a Borrower; or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person (other than any Affiliate of a Borrower).

7.4 Indebtedness. Create, incur, assume or be or remain liable with respect to any Indebtedness, or permit any Subsidiary so to do, other than Permitted Indebtedness.

7.5 Encumbrances. Create, incur, assume or suffer to exist any Lien with respect to any of its property, or assign or otherwise convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries so to do, except for Permitted Liens. Agree with any Person other than Bank not to grant a security interest in, or otherwise encumber, any of its property, or permit any Subsidiary to do so.

7.6 Distributions. Pay any dividends or make any other distribution or payment on account of or in redemption, retirement or purchase of any capital stock, or permit any of its Subsidiaries to do so, except that Borrower may repurchase the stock of former employees pursuant to stock repurchase agreements as long as an Event of Default does not exist prior to such repurchase or would not exist after giving effect to such repurchase.

7.7 Investments. Directly or indirectly acquire or own, or make any Investment in or to any Person, or permit any of its Subsidiaries so to do, other than Permitted Investments; or maintain or invest any of its property with a Person other than Bank or permit any of its Subsidiaries to do so unless such Person has entered into an account control agreement with Bank in form and substance satisfactory to Bank; or suffer or permit any Subsidiary to be

a party to, or be bound by, an agreement that restricts such Subsidiary from paying dividends or otherwise distributing property to Borrower.

7.8 Transactions with Affiliates . Directly or indirectly enter into or permit to exist any material transaction with any Affiliate of Borrower except for transactions that are in the ordinary course of Borrower's business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm's length transaction with a non-affiliated Person.

7.9 Subordinated Debt . Make any payment in respect of any Subordinated Debt, or permit any of its Subsidiaries to make any such payment, except in compliance with the terms of such Subordinated Debt, or amend any provision contained in any documentation relating to the Subordinated Debt without Bank's prior written consent.

7.10 Inventory and Equipment . Store the Inventory or the Equipment with a bailee, warehouseman, or other third party unless the third party has been notified of Bank's security interest and Bank (a) has received an acknowledgment from the third party that it is holding or will hold the Inventory or Equipment for Bank's benefit or (b) is in pledge possession of the warehouse receipt, where negotiable, covering such Inventory or Equipment. Store or maintain any Equipment or Inventory at a location other than the location set forth in Section 10 of this Agreement.

7.11 Compliance . Become an "investment company" or be controlled by an "investment company," within the meaning of the Investment Company Act of 1940, or become principally engaged in, or undertake as one of its important activities, the business of extending credit for the purpose of purchasing or carrying margin stock, or use the proceeds of any Credit Extension for such purpose. Fail to meet the minimum funding requirements of ERISA, permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur, fail to comply with the Federal Fair Labor Standards Act or violate any law or regulation, which violation could have a Material Adverse Effect or a material adverse effect on the Collateral or the priority of Bank's Lien on the Collateral, or permit any of its Subsidiaries to do any of the foregoing.

## 8. EVENTS OF DEFAULT .

Any one or more of the following events shall constitute an "Event of Default" by Borrowers under this Agreement:

8.1 Payment Default . If Borrowers fail to pay any of the Obligations within three (3) days after the date when due;

8.2 Covenant Default . If a Borrower fails to perform any obligation under Article 6 or violates any of the covenants contained in Article 7 of this Agreement, or fails or neglects to perform, keep, or observe any other material term, provision, condition, covenant, or agreement contained in this Agreement, in any of the Loan Documents, or in any other present or future agreement between a Borrower and Bank and as to any default under such other term, provision, condition, covenant or agreement; and a Borrower has failed to cure such default within ten (10) days after a Borrower receives notice thereof or any officer of a Borrower becomes aware thereof; provided, however, that if the default cannot by its nature be cured within the ten (10) day period or cannot after diligent attempts by Borrowers be cured within such ten (10) day period, and such default is likely to be cured within a reasonable time, then Borrowers shall have an additional reasonable period (which shall not in any case exceed thirty (30) days) to attempt to cure such default, and within such reasonable time period the failure to have cured such default shall not be deemed an Event of Default but no Credit Extensions will be made;

8.3 Material Adverse Effect . If there occurs any circumstance or circumstances that could reasonably be expected to have a Material Adverse Effect;

8.4 Attachment . If any portion of a Borrower's assets is attached, seized, subjected to a writ or distress warrant, or is levied upon, or comes into the possession of any trustee, receiver or person acting in a similar capacity and such attachment, seizure, writ or distress warrant or levy has not been removed, discharged or rescinded within ten (10) days, or if a Borrower is enjoined, restrained, or in any way prevented by court order from continuing to

conduct all or any material part of its business affairs, or if a judgment or other claim becomes a lien or encumbrance upon any material portion of a Borrower's assets, or if a notice of lien, levy, or assessment is filed of record with respect to any of a Borrower's assets by the United States Government, or any department, agency, or instrumentality thereof, or by any state, county, municipal, or governmental agency, and the same is not paid within ten (10) days after a Borrower receives notice thereof, provided that none of the foregoing shall constitute an Event of Default where such action or event is stayed or an adequate bond has been posted pending a good faith contest by Borrowers (provided that no Credit Extensions will be required to be made during such cure period);

8.5 Insolvency . If a Borrower becomes insolvent, or if an Insolvency Proceeding is commenced by a Borrower, or if an Insolvency Proceeding is commenced against a Borrower and is not dismissed or stayed within thirty (30) days (provided that no Credit Extensions will be made prior to the dismissal of such Insolvency Proceeding);

8.6 Other Agreements . If there is a default or other failure to perform in any agreement to which a Borrower is a party or by which it is bound resulting in a right by a third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness in an amount in excess of \$100,000); or which could have a Material Adverse Effect;

8.7 Subordinated Debt . If a Borrower makes any payment on account of Subordinated Debt, except to the extent such payment is allowed under any subordination agreement entered into with Bank;

8.8 Judgments . If a judgment or judgments for the payment of money in an amount, individually or in the aggregate, of at least \$100,000 shall be rendered against a Borrower and shall remain unsatisfied and unstayed for a period of ten (10) days (provided that no Credit Extensions will be made prior to the satisfaction or stay of such judgment);

8.9 Misrepresentations . If any material misrepresentation or material misstatement exists now or hereafter in any warranty or representation set forth herein or in any certificate delivered to Bank by any Responsible Officer pursuant to this Agreement or to induce Bank to enter into this Agreement or any other Loan Document; or

8.10 Guaranty . If any guaranty of all or a portion of the Obligations (a "Guaranty") ceases for any reason to be in full force and effect, or any guarantor fails to perform any obligation under any Guaranty or a security agreement securing any Guaranty (collectively, the "Guaranty Documents"), or any event of default occurs under any Guaranty Document or any guarantor revokes or purports to revoke a Guaranty, or any material misrepresentation or material misstatement exists now or hereafter in any warranty or representation set forth in any Guaranty Document or in any certificate delivered to Bank in connection with any Guaranty Document, or if any of the circumstances described in Sections 8.3 through 8.9 occur with respect to any guarantor or any guarantor dies or becomes subject to any criminal prosecution.

## 9. BANK'S RIGHTS AND REMEDIES .

9.1 Rights and Remedies . Upon the occurrence and during the continuance of an Event of Default, Bank may, at its election, without prior notice (but with notice promptly after the election of the Bank to so act) of its election and without demand, do any one or more of the following, all of which are authorized by each Borrower:

(a) Declare all Obligations, whether evidenced by this Agreement, by any of the other Loan Documents, or otherwise, immediately due and payable (provided that upon the occurrence of an Event of Default described in Section 8.5 all Obligations shall become immediately due and payable without any action by Bank);

(b) Demand that Borrower (i) deposit cash with Bank in an amount equal to the amount of any Letters of Credit remaining undrawn, as collateral security for the repayment of any future drawings under such Letters of Credit, and (ii) pay in advance all Letter of Credit fees scheduled to be paid or payable over the remaining term of the Letters of Credit, and Borrower shall promptly deposit and pay such amounts;

(c) Cease advancing money or extending credit to or for the benefit of Borrower under this Agreement or under any other agreement between Borrower and Bank;

(d) Settle or adjust disputes and claims directly with account debtors for amounts, upon terms and in whatever order that Bank reasonably considers advisable;

(e) Make such payments and do such acts as Bank considers necessary or reasonable to protect its security interest in the Collateral. Borrower agrees to assemble the Collateral if Bank so requires, and to make the Collateral available to Bank as Bank may designate. Borrower authorizes Bank to enter the premises where the Collateral is located, to take and maintain possession of the Collateral, or any part of it, and to pay, purchase, contest, or compromise any encumbrance, charge, or lien which in Bank's determination appears to be prior or superior to its security interest and to pay all expenses incurred in connection therewith. With respect to any of Borrower's owned premises, Borrower hereby grants Bank a license to enter into possession of such premises and to occupy the same, without charge, in order to exercise any of Bank's rights or remedies provided herein, at law, in equity, or otherwise;

(f) Set off and apply to the Obligations any and all (i) balances and deposits of Borrower held by Bank, or (ii) indebtedness at any time owing to or for the credit or the account of Borrower held by Bank;

(g) Ship, reclaim, recover, store, finish, maintain, repair, prepare for sale, advertise for sale, and sell (in the manner provided for herein) the Collateral. Bank is hereby granted a license or other right, solely pursuant to the provisions of this Section 9.1, to use, without charge, Borrower's labels, patents, copyrights, rights of use of any name, trade secrets, trade names, trademarks, service marks, and advertising matter, or any property of a similar nature, as it pertains to the Collateral, in completing production of, advertising for sale, and selling any Collateral and, in connection with Bank's exercise of its rights under this Section 9.1, Borrower's rights under all licenses and all franchise agreements shall inure to Bank's benefit;

(h) Dispose of the Collateral by way of one or more contracts or transactions, for cash or on terms, in such manner and at such places (including Borrower's premises) as Bank determines is commercially reasonable, and apply any proceeds to the Obligations in whatever manner or order Bank deems appropriate;

(i) Bank may credit bid and purchase at any public sale; and

(j) Any deficiency that exists after disposition of the Collateral as provided above will be paid immediately by Borrowers.

**9.2 Power of Attorney.** Effective only upon the occurrence and during the continuance of an Event of Default, each Borrower hereby irrevocably appoints Bank (and any of Bank's designated officers, or employees) as such Borrower's true and lawful attorney to: (a) send requests for verification of Accounts or notify account debtors of Bank's security interest in the Accounts; (b) endorse Borrower's name on any checks or other forms of payment or security that may come into Bank's possession; (c) sign Borrower's name on any invoice or bill of lading relating to any Account, drafts against account debtors, schedules and assignments of Accounts, verifications of Accounts, and notices to account debtors; (d) dispose of any Collateral; (e) make, settle, and adjust all claims under and decisions with respect to Borrower's policies of insurance; (f) settle and adjust disputes and claims respecting the accounts directly with account debtors, for amounts and upon terms which Bank determines to be reasonable; (g) to file, in its sole discretion, one or more financing or continuation statements and amendments thereto, relative to any of the Collateral; and (h) to transfer the Intellectual Property Collateral into the name of Bank or a third party to the extent permitted under the California Uniform Commercial Code; provided Bank may exercise such power of attorney to sign the name of Borrower on any of the documents described in Section 4.2 regardless of whether an Event of Default has occurred, including without limitation to modify, in its sole discretion, any intellectual property security agreement entered into between Borrower and Bank without first obtaining Borrower's approval of or signature to such modification by amending Exhibits A, B, and C, thereof, as appropriate, to include reference to any right, title or interest in any Copyrights, Patents or Trademarks acquired by Borrower after the execution hereof or to delete any reference to any right, title or interest in any Copyrights, Patents or Trademarks in which Borrower no longer has or claims to have any right, title or interest. The appointment of Bank as each Borrower's attorney in fact, and each and every one of Bank's rights and powers, being coupled with an interest, is irrevocable until all of the Obligations have been fully repaid and performed and Bank's obligation to provide Credit Extensions hereunder is terminated.

9.3 Accounts Collection. At any time during the occurrence and continuation of an Event of Default, Bank may notify any Person owing funds to a Borrower of Bank's security interest in such funds and verify the amount of such Account. Each Borrower shall collect all amounts owing to such Borrower for Bank, receive in trust all payments as Bank's trustee, and immediately deliver such payments to Bank in their original form as received from the account debtor, with proper endorsements for deposit.

9.4 Bank Expenses. If a Borrower fails to pay any amounts or furnish any required proof of payment due to third persons or entities, as required under the terms of this Agreement, then Bank may do any or all of the following after reasonable notice to Borrowers: (a) make payment of the same or any part thereof; (b) set up such reserves under a loan facility in Section 2.1 as Bank deems necessary to protect Bank from the exposure created by such failure; or (c) obtain and maintain insurance policies of the type discussed in Section 6.6 of this Agreement, and take any action with respect to such policies as Bank deems prudent. Any amounts so paid or deposited by Bank shall constitute Bank Expenses, shall be immediately due and payable, and shall bear interest at the then applicable rate hereinabove provided, and shall be secured by the Collateral. Any payments made by Bank shall not constitute an agreement by Bank to make similar payments in the future or a waiver by Bank of any Event of Default under this Agreement.

9.5 Bank's Liability for Collateral. So long as Bank complies with reasonable banking practices and its actions do not constitute gross negligence or willful misconduct, Bank shall not in any way or manner be liable or responsible for: (a) the safekeeping of the Collateral; (b) any loss or damage thereto occurring or arising in any manner or fashion from any cause; (c) any diminution in the value thereof; or (d) any act or default of any carrier, warehouseman, bailee, forwarding agency, or other person whomsoever. Except as set forth in the previous sentence, all risk of loss, damage or destruction of the Collateral shall be borne by Borrowers.

9.6 Remedies Cumulative. Bank's rights and remedies under this Agreement, the Loan Documents, and all other agreements shall be cumulative. Bank shall have all other rights and remedies not inconsistent herewith as provided under the Code, by law, or in equity. No exercise by Bank of one right or remedy shall be deemed an election, and no waiver by Bank of any Event of Default on a Borrower's part shall be deemed a continuing waiver. No delay by Bank shall constitute a waiver, election, or acquiescence by it. No waiver by Bank shall be effective unless made in a written document signed on behalf of Bank and then shall be effective only in the specific instance and for the specific purpose for which it was given.

9.7 Demand; Protest. Each Borrower waives demand, protest, notice of protest, notice of default or dishonor, notice of payment and nonpayment, notice of any default, nonpayment at maturity, release, compromise, settlement, extension, or renewal of accounts, documents, instruments, chattel paper, and guarantees at any time held by Bank on which a Borrower may in any way be liable.

## 10. NOTICES.

Unless otherwise provided in this Agreement, all notices or demands by any party relating to this Agreement or any other agreement entered into in connection herewith shall be in writing and (except for financial statements and other informational documents which may be sent by first-class mail, postage prepaid) shall be personally delivered or sent by a recognized overnight delivery service, certified mail, postage prepaid, return receipt requested, or by telefacsimile to Borrowers or to Bank, as the case may be, at its addresses set forth below:

If to any Borrower:	Alliance Consulting Group Associates, Inc. and Alliance Holdings, Inc. Six Tower Bridge 181 Washington Street Suite 350 Conshohocken, PA 19428 Attn: Chief Financial Officer FAX: 610-234-4331
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If to Bank:	Comerica Bank 75 E Trimble Road
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Mail Code 4770  
San Jose, CA 95131  
Attn: Manager  
FAX: (408) 556-5091

with a copy to:

Comerica Bank  
11921 Freedom Drive  
Suite 920  
Reston, VA 20190  
Attn: Beth Kinsey  
FAX: (703) 467-9308

The parties hereto may change the address at which they are to receive notices hereunder, by notice in writing in the foregoing manner given to the other.

**11. CHOICE OF LAW AND VENUE: JURY TRIAL WAIVER.**

This Agreement shall be governed by, and construed in accordance with, the internal laws of the State of California, without regard to principles of conflicts of law. Each of Borrower and Bank hereby submits to the exclusive jurisdiction of the state and Federal courts located in the County of Santa Clara, State of California. BORROWERS AND BANK EACH HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF ANY OF THE LOAN DOCUMENTS OR ANY OF THE TRANSACTIONS CONTEMPLATED THEREIN, INCLUDING CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW OR STATUTORY CLAIMS. EACH PARTY RECOGNIZES AND AGREES THAT THE FOREGOING WAIVER CONSTITUTES A MATERIAL INDUCEMENT FOR IT TO ENTER INTO THIS AGREEMENT. EACH PARTY REPRESENTS AND WARRANTS THAT IT HAS REVIEWED THIS WAIVER WITH ITS LEGAL COUNSEL AND THAT IT KNOWINGLY AND VOLUNTARILY WAIVES ITS JURY TRIAL RIGHTS FOLLOWING CONSULTATION WITH LEGAL COUNSEL.

**12. REFERENCE PROVISION.**

12.1 In the event the Jury Trial Waiver set forth above is not enforceable, the parties elect to proceed under this Judicial Reference Provision.

12.2 With the exception of the items specified in clause 12.3, below, any controversy, dispute or claim (each, a "Claim") between the parties arising out of or relating to this Agreement or any other document, instrument or agreement between the undersigned parties (collectively in this Section, the "Comerica Documents"), will be resolved by a reference proceeding in California in accordance with the provisions of Sections 638 et seq. of the California Code of Civil Procedure ("CCP"), or their successor sections, which shall constitute the exclusive remedy for the resolution of any Claim, including whether the Claim is subject to the reference proceeding. Except as otherwise provided in the Comerica Documents, venue for the reference proceeding will be in the state or federal court in the county or district where the real property involved in the action, if any, is located or in the state or federal court in the county or district where venue is otherwise appropriate under applicable law (the "Court").

12.3 The matters that shall not be subject to a reference are the following: (i) nonjudicial foreclosure of any security interests in real or personal property, (ii) exercise of self-help remedies (including, without limitation, set-off), (iii) appointment of a receiver and (iv) temporary, provisional or ancillary remedies (including, without limitation, writs of attachment, writs of possession, temporary restraining orders or preliminary injunctions). This reference provision does not limit the right of any party to exercise or oppose any of the rights and remedies described in clauses (i) and (ii) or to seek or oppose from a court of competent jurisdiction any of the items described in clauses (iii) and (iv). The exercise of, or opposition to, any of those items does not waive the right of any party to a reference pursuant to this reference provision as provided herein.

12.4 The referee shall be a retired judge or justice selected by mutual written agreement of the parties. If the parties do not agree within ten (10) days of a written request to do so by any party, then, upon request of any party, the referee shall be selected by the Presiding Judge of the Court (or his or her representative). A request for appointment of a referee may be heard on an ex parte or expedited basis, and the parties agree that irreparable harm would result if ex parte relief is not granted. Pursuant to CCP § 170.6, each party shall have one preemptory challenge to the referee selected by the Presiding Judge of the Court (or his or her representative).

12.5 The parties agree that time is of the essence in conducting the reference proceedings. Accordingly, the referee shall be requested, subject to change in the time periods specified herein for good cause shown, to (i) set the matter for a status and trial-setting conference within fifteen (15) days after the date of selection of the referee, (ii) if practicable, try all issues of law or fact within one hundred twenty (120) days after the date of the conference and (iii) report a statement of decision within twenty (20) days after the matter has been submitted for decision.

12.6 The referee will have power to expand or limit the amount and duration of discovery. The referee may set or extend discovery deadlines or cutoffs for good cause, including a party's failure to provide requested discovery for any reason whatsoever. Unless otherwise ordered based upon good cause shown, no party shall be entitled to "priority" in conducting discovery, depositions may be taken by either party upon seven (7) days written notice, and all other discovery shall be responded to within fifteen (15) days after service. All disputes relating to discovery which cannot be resolved by the parties shall be submitted to the referee whose decision shall be final and binding.

12.7 Except as expressly set forth herein, the referee shall determine the manner in which the reference proceeding is conducted including the time and place of hearings, the order of presentation of evidence, and all other questions that arise with respect to the course of the reference proceeding. All proceedings and hearings conducted before the referee, except for trial, shall be conducted without a court reporter, except that when any party so requests, a court reporter will be used at any hearing conducted before the referee, and the referee will be provided a courtesy copy of the transcript. The party making such a request shall have the obligation to arrange for and pay the court reporter. Subject to the referee's power to award costs to the prevailing party, the parties will equally share the cost of the referee and the court reporter at trial.

12.8 The referee shall be required to determine all issues in accordance with existing case law and the statutory laws of the State of California. The rules of evidence applicable to proceedings at law in the State of California will be applicable to the reference proceeding. The referee shall be empowered to enter equitable as well as legal relief, enter equitable orders that will be binding on the parties and rule on any motion which would be authorized in a court proceeding, including without limitation motions for summary judgment or summary adjudication. The referee shall issue a decision at the close of the reference proceeding which disposes of all claims of the parties that are the subject of the reference. Pursuant to CCP § 644, such decision shall be entered by the Court as a judgment or an order in the same manner as if the action had been tried by the Court and any such decision will be final, binding and conclusive. The parties reserve the right to appeal from the final judgment or order or from any appealable decision or order entered by the referee. The parties reserve the right to findings of fact, conclusions of laws, a written statement of decision, and the right to move for a new trial or a different judgment, which new trial, if granted, is also to be a reference proceeding under this provision.

12.9 If the enabling legislation which provides for appointment of a referee is repealed (and no successor statute is enacted), any dispute between the parties that would otherwise be determined by reference procedure will be resolved and determined by arbitration. The arbitration will be conducted by a retired judge or justice, in accordance with the California Arbitration Act §1280 through §1294.2 of the CCP as amended from time to time. The limitations with respect to discovery set forth above shall apply to any such arbitration proceeding.

12.10 THE PARTIES RECOGNIZE AND AGREE THAT ALL CONTROVERSIES, DISPUTES AND CLAIMS RESOLVED UNDER THIS REFERENCE PROVISION WILL BE DECIDED BY A REFEREE AND NOT BY A JURY. AFTER CONSULTING (OR HAVING HAD THE OPPORTUNITY TO CONSULT) WITH COUNSEL OF ITS, HIS OR HER OWN CHOICE, EACH PARTY KNOWINGLY AND VOLUNTARILY, AND FOR THE MUTUAL BENEFIT OF ALL PARTIES, AGREES THAT THIS REFERENCE PROVISION WILL

APPLY TO ANY CONTROVERSY, DISPUTE OR CLAIM BETWEEN OR AMONG THEM ARISING OUT OF OR IN ANY WAY RELATED TO, THIS AGREEMENT OR THE OTHER COMERICA DOCUMENTS.

### 13. GENERAL PROVISIONS.

13.1 Successors and Assigns. This Agreement shall bind and inure to the benefit of the respective successors and permitted assigns of each of the parties; provided, however, that neither this Agreement nor any rights hereunder may be assigned by Borrower without Bank's prior written consent, which consent may be granted or withheld in Bank's sole discretion. Bank shall have the right without the consent of or notice to Borrowers to sell, transfer, negotiate, or grant participation in all or any part of, or any interest in, Bank's obligations, rights and benefits hereunder.

13.2 Indemnification. Each Borrower shall defend, indemnify and hold harmless Bank and its officers, employees, and agents against: (a) all obligations, demands, claims, and liabilities claimed or asserted by any other party in connection with the transactions contemplated by this Agreement; and (b) all losses or Bank Expenses in any way suffered, incurred, or paid by Bank as a result of or in any way arising out of, following, or consequential to transactions between Bank and a Borrower whether under this Agreement, or otherwise (including without limitation reasonable attorneys fees and expenses), except for losses caused by Bank's gross negligence or willful misconduct.

13.3 Time of Essence. Time is of the essence for the performance of all obligations set forth in this Agreement.

13.4 Severability of Provisions. Each provision of this Agreement shall be severable from every other provision of this Agreement for the purpose of determining the legal enforceability of any specific provision.

13.5 Amendments in Writing, Integration. Neither this Agreement nor the Loan Documents can be amended or terminated orally. All prior agreements, understandings, representations, warranties, and negotiations between the parties hereto with respect to the subject matter of this Agreement and the Loan Documents, if any, are merged into this Agreement and the Loan Documents.

13.6 Counterparts. This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, shall be deemed to be an original, and all of which, when taken together, shall constitute but one and the same Agreement.

13.7 Survival. All covenants, representations and warranties made in this Agreement shall continue in full force and effect so long as any Obligations remain outstanding or Bank has any obligation to make Credit Extensions to Borrowers. The obligations of each Borrower to indemnify Bank with respect to the expenses, damages, losses, costs and liabilities described in Section 12.2 shall survive until all applicable statute of limitations periods with respect to actions that may be brought against Bank have run.

13.8 Effect of Amendment and Restatement. This Agreement is intended to and does completely amend and restate, without novation, the Original Agreement. All security interests granted under the Original Agreement are hereby confirmed and ratified and shall continue to secure all Obligations under this Agreement.

### 14. CO-BORROWER PROVISIONS.

14.1 Primary Obligation. This Agreement is a primary and original obligation of each Borrower and shall remain in effect notwithstanding future changes in conditions, including any change of law or any invalidity or irregularity in the creation or acquisition of any Obligations or in the execution or delivery of any agreement between Bank and any Borrower. Each Borrower shall be liable for existing and future Obligations as fully as if all of all Credit Extensions were advanced to such Borrower. Bank may rely on any certificate or representation made by any Borrower as made on behalf of, and binding on, all Borrowers, including without limitation Advance Request Forms, and Compliance Certificates.

14.2 Enforcement of Rights . Borrowers are jointly and severally liable for the Obligations and Bank may proceed against one or more of the Borrowers to enforce the Obligations without waiving its right to proceed against any of the other Borrowers.

14.3 Borrowers as Agents . Each Borrower appoints the other Borrower as its agent with all necessary power and authority to give and receive notices, certificates or demands for and on behalf of both Borrowers, to act as disbursing agent for receipt of any Advances on behalf of each Borrower and to apply to Bank on behalf of each Borrower for Advances, any waivers and any consents. This authorization cannot be revoked, and Bank need not inquire as to each Borrower's authority to act for or on behalf of Borrower.

14.4 Subrogation and Similar Rights . Notwithstanding any other provision of this Agreement or any other Loan Document, each Borrower irrevocably waives all rights that it may have at law or in equity (including, without limitation, any law subrogating the Borrower to the rights of Bank under the Loan Documents) to seek contribution, indemnification, or any other form of reimbursement from any other Borrower, or any other Person now or hereafter primarily or secondarily liable for any of the Obligations, for any payment made by the Borrower with respect to the Obligations in connection with the Loan Documents or otherwise and all rights that it might have to benefit from, or to participate in, any security for the Obligations as a result of any payment made by the Borrower with respect to the Obligations in connection with the Loan Documents or otherwise. Any agreement providing for indemnification, reimbursement or any other arrangement prohibited under this Section 13.4 shall be null and void. If any payment is made to a Borrower in contravention of this Section 13.4, such Borrower shall hold such payment in trust for Bank and such payment shall be promptly delivered to Bank for application to the Obligations, whether matured or unmatured.

14.5 Waivers of Notice . Except as otherwise provided in this Agreement, each Borrower waives notice of acceptance hereof; notice of the existence, creation or acquisition of any of the Obligations; notice of an Event of Default; notice of the amount of the Obligations outstanding at any time; notice of intent to accelerate; notice of acceleration; notice of any adverse change in the financial condition of any other Borrower or of any other fact that might increase the Borrower's risk; presentment for payment; demand; protest and notice thereof as to any instrument; default; and all other notices and demands to which the Borrower would otherwise be entitled. Each Borrower waives any defense arising from any defense of any other Borrower, or by reason of the cessation from any cause whatsoever of the liability of any other Borrower. Bank's failure at any time to require strict performance by any Borrower of any provision of the Loan Documents shall not waive, alter or diminish any right of Bank thereafter to demand strict compliance and performance therewith. Nothing contained herein shall prevent Bank from foreclosing on the Lien of any deed of trust, mortgage or other security instrument, or exercising any rights available thereunder, and the exercise of any such rights shall not constitute a legal or equitable discharge of any Borrower. Each Borrower also waives any defense arising from any act or omission of Bank that changes the scope of the Borrower's risks hereunder.

14.6 Subrogation Defenses . Each Borrower hereby waives any defense based on impairment or destruction of its subrogation or other rights against any other Borrower and waives all benefits which might otherwise be available to it under California Civil Code Sections 2809, 2810, 2819, 2839, 2845, 2848, 2849, 2850, 2899, and 3433 and California Code of Civil Procedure Sections 580a, 580b, 580d and 726, as those statutory provisions are now in effect and hereafter amended, and under any other similar statutes now and hereafter in effect.

14.7 Right to Settle, Release .

(a) The liability of Borrowers hereunder shall not be diminished by (i) any agreement, understanding or representation that any of the Obligations is or was to be guaranteed by another Person or secured by other property, or (ii) any release or unenforceability, whether partial or total, of rights, if any, which Bank may now or hereafter have against any other Person, including another Borrower, or property with respect to any of the Obligations.

(b) Without affecting the liability of any Borrower hereunder, Bank may (i) compromise, settle, renew, extend the time for payment, change the manner or terms of payment, discharge the performance of, decline to enforce, or release all or any of the Obligations with respect to a Borrower, (ii) grant other indulgences to a Borrower in respect of the Obligations, (iii) modify in any manner any documents relating to the Obligations with respect to a Borrower, (iv) release, surrender or exchange any deposits or other property securing the Obligations, whether pledged by a Borrower or any other Person, or (v) compromise, settle, renew, or extend the time for

payment, discharge the performance of, decline to enforce, or release all or any obligations of any guarantor, endorser or other Person who is now or may hereafter be liable with respect to any of the Obligations.

14.8 Subordination . All indebtedness of a Borrower now or hereafter arising held by another Borrower is subordinated to the Obligations and the Borrower holding the indebtedness shall take all actions reasonably requested by Lender to effect, to enforce and to give notice of such subordination.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first above written.

ALLIANCE CONSULTING GROUP ASSOCIATES, INC.

By: /s/ Jeffrey B. McGroarty

Title: Vice President

ALLIANCE HOLDINGS, INC.

By: /s/ Steven Grenfell

Title: Vice President

COMERICA BANK

By: /s/ Beth Kinsey

Title: Senior Vice President

**DEBTOR:**                   **ALLIANCE CONSULTING GROUP ASSOCIATES, INC.**  
**ALLIANCE HOLDINGS, INC.**

**SECURED PARTY:**       **COMERICA BANK**

EXHIBIT A

COLLATERAL DESCRIPTION ATTACHMENT  
TO LOAN AND SECURITY AGREEMENT

All personal property of Borrower (herein referred to as "Borrower" or "Debtor") whether presently existing or hereafter created or acquired, and wherever located, including, but not limited to:

(a) all accounts (including health-care-insurance receivables), chattel paper (including tangible and electronic chattel paper), deposit accounts, documents (including negotiable documents), equipment (including all accessions and additions thereto), general intangibles (including payment intangibles and software), goods (including fixtures), instruments (including promissory notes), inventory (including all goods held for sale or lease or to be furnished under a contract of service, and including returns and repossessions), investment property (including securities and securities entitlements), letter of credit rights, money, and all of Debtor's books and records with respect to any of the foregoing, and the computers and equipment containing said books and records;

(b) all common law and statutory copyrights and copyright registrations, applications for registration, now existing or hereafter arising, in the United States of America or in any foreign jurisdiction, obtained or to be obtained on or in connection with any of the foregoing, or any parts thereof or any underlying or component elements of any of the foregoing, together with the right to copyright and all rights to renew or extend such copyrights and the right (but not the obligation) of Secured Party to sue in its own name and/or in the name of the Debtor for past, present and future infringements of copyright;

(c) all trademarks, service marks, trade names and service names and the goodwill associated therewith, together with the right to trademark and all rights to renew or extend such trademarks and the right (but not the obligation) of Secured Party to sue in its own name and/or in the name of the Debtor for past, present and future infringements of trademark;

(d) all (i) patents and patent applications filed in the United States Patent and Trademark Office or any similar office of any foreign jurisdiction, and interests under patent license agreements, including, without limitation, the inventions and improvements described and claimed therein, (ii) licenses pertaining to any patent whether Debtor is licensor or licensee, (iii) income, royalties, damages, payments, accounts and accounts receivable now or hereafter due and/or payable under and with respect thereto, including, without limitation, damages and payments for past, present or future infringements thereof, (iv) right (but not the obligation) to sue in the name of Debtor and/or in the name of Secured Party for past, present and future infringements thereof, (v) rights corresponding thereto throughout the world in all jurisdictions in which such patents have been issued or applied for, and (vi) reissues, divisions, continuations, renewals, extensions and continuations-in-part with respect to any of the foregoing; and

(e) any and all cash proceeds and/or noncash proceeds of any of the foregoing, including, without limitation, insurance proceeds, and all supporting obligations and the security therefor or for any right to payment. All terms above have the meanings given to them in the California Uniform Commercial Code, as amended or supplemented from time to time, including revised Division 9 of the Uniform Commercial Code-Secured Transactions, added by Stats. 1999, c.991 (S.B. 45), Section 35, operative July 1, 2001.



AFFIRMATION OF GUARANTY  
(Safeguard Delaware / Safeguard Scientifics (Delaware))

This AFFIRMATION OF GUARANTY is made as of February 28, 2007, by the undersigned (each a “Guarantor”; collectively, the “Guarantors”) and COMERICA BANK (“Bank”).

RECITALS

Borrowers and Bank are parties to that certain Loan and Security Agreement dated as of September 25, 2003, as amended, including, without limitation, by that certain First Amendment to Loan and Security Agreement dated as of December 12, 2003, that certain Second Amendment to Loan and Security Agreement dated as of May 27, 2004, that certain Third Amendment to Loan Documents dated as of August 9, 2004, that certain Fourth Amendment to Loan Documents dated as of September 30, 2004, that certain Fifth Amendment to Loan Documents dated as of March 11, 2005, that certain Sixth Amendment to Loan Documents dated as of June 30, 2005, that certain Seventh Amendment to Loan Documents dated as of February 28, 2006, that certain Eighth Amendment and Consent to Loan Documents dated as of April 27, 2006, that certain Consent to Loan Documents dated as of July 13, 2006 and that certain Ninth Amendment and Waiver to Loan Documents dated December 29, 2006 (collectively, the “Agreement”) and that certain LIBOR Addendum to Loan and Security Agreement dated as of September 25, 2003 (the “LIBOR Addendum”)(the Agreement and the LIBOR Addendum, collectively, the “Original Agreement”).

Guarantors executed for the benefit of Bank an Unconditional Guaranty dated as of September 30, 2004 (the “Guaranty”), guarantying certain amounts owing by Borrowers to Bank under the Original Agreement. Borrowers and Bank wish to amend and restate the terms of the Original Agreement and to evidence the obligations of Borrowers to Bank in two separate agreements, one subject to a guaranty and the other not. The Amended and Restated Loan and Security Agreement dated as of the date hereof sets forth the terms on which Bank will advance credit to Borrowers in respect of the guaranteed loans in the maximum principal amount of \$5,000,000 (the “Guarantied Loan Agreement”). Bank has agreed to enter into the Guarantied Loan Agreement provided, among other things, that Guarantors consent to the entry by Borrowers into the Guarantied Loan Agreement and related documents and agrees that the Guaranty will remain effective.

AGREEMENT

NOW, THEREFORE, Guarantors agree as follows:

1. Each Guarantor consents to the execution, delivery and performance by Borrower of the Guarantied Loan Agreement and the documents and instruments executed in connection therewith, as well as all other amendments and modifications to the Loan Documents.
  2. The Guaranty is and shall remain in full force and effect with respect to all of Borrowers’ Obligations as defined in the Guarantied Loan Agreement. Each Guarantor confirms that, as of the date hereof, it has no defenses against its obligations under the Guaranty.
  3. Each Guarantor represents and warrants that the Representations and Warranties contained in the Guaranty are true and correct as of the date of this Affirmation except (i) to the extent such representations and warranties expressly relate to an earlier date, which representations and warranties are true and correct as of such date; and (ii) for those changes to the representations and warranties resulting from events, occurrences or circumstances permitted under the applicable Loan Documents. Unless otherwise defined, all capitalized terms in this Affirmation shall be as defined in the Guaranty.
  4. The Guaranty, as amended hereby, shall be and remain in full force and effect in accordance with its respective terms and hereby is ratified and confirmed in all respects. Except as expressly set forth herein, the
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execution, delivery, and performance of this Affirmation and shall not operate as a waiver of, or as an amendment of, any right, power, or remedy of Bank under the Guaranty, as in effect prior to the date hereof. Each Guarantor ratifies and reaffirms the continuing effectiveness of all instruments, documents and agreements entered into in connection with the Guaranty.

IN WITNESS WHEREOF, the undersigned Guarantors have executed this Affirmation of Guaranty as of the first date above written.

SAFEGUARD DELAWARE, INC.

By: /s/ Steven J. Feder \_\_\_\_\_

Title: Vice President

SAFEGUARD SCIENTIFICS (DELAWARE), INC.

By: /s/ Steven J. Feder \_\_\_\_\_

Title: Vice President

COMERICA BANK

By: /s/ Beth Kinsey \_\_\_\_\_

Title: Senior Vice President



SIXTH AMENDMENT  
TO  
LOAN AND SECURITY AGREEMENT

This Sixth Amendment to Loan and Security Agreement is entered into as of February 28, 2007 (the "Amendment") by and between COMERICA BANK ("Bank") and LAUREATE PHARMA, INC. ("Borrower").

RECITALS

Borrower and Bank are parties to that certain Loan and Security Agreement dated as of December 1, 2004, as amended, including, without limitation, by that certain First Amendment to Loan and Security Agreement dated as of January 31, 2005, that certain Second Amendment to Loan and Security Agreement dated as of May 6, 2005, that certain Third Amendment to Loan and Security Agreement dated as of June 20, 2005, that certain letter agreement dated as of January 28, 2006, that certain Fourth Amendment to Loan and Security Agreement dated as of February 28, 2006, and that certain Fifth Amendment to Loan and Security Agreement dated as of August 2, 2006 (collectively, the "Agreement"). The parties desire to amend the Agreement in accordance with the terms of this Amendment.

NOW, THEREFORE, the parties agree as follows:

1. The following defined terms are added to or amended in Section 1.1 of the Agreement to read as follows:

"Equipment Advance(s)" means a cash advance or cash advances under the Equipment Line.

"Equipment Line" means a Credit Extension of up to Six Million Dollars (\$6,000,000).

"Equipment Maturity Date" means February 28, 2011.

"Guaranty Amount" means Fifteen Million Dollars (\$15,000,000).

"Revolving Line" means, as of any date of determination, a credit extension of Twelve Million Dollars (\$12,000,000).

"Revolving Maturity Date" means February 27, 2008.

"Tangible Net Worth" means at any date as of which the amount thereof shall be determined, the sum of the capital stock, partnership interest or limited liability company interest of Borrower and its Subsidiaries, plus Subordinated Debt, minus intangible assets, determined in accordance with GAAP.

"Tranche A" has the meaning assigned in Section 2.1(c)(i).

"Tranche B" has the meaning assigned in Section 2.1(c)(i).

"Tranche A Equipment Advance" or "Tranche A Equipment Advances" means any Equipment Advances(s) made under Tranche A.

"Tranche B Equipment Advance" or "Tranche B Equipment Advances" means any Equipment Advances(s) made under Tranche B.

"Tranche A Availability End Date" means August 28, 2007.

"Tranche B Availability End Date" means February 28, 2008.

2. Section 2.1(b) of the Agreement is amended in its entirety to read as follows:

Existing Term Loan. As of February 28, 2007, there is an outstanding term loan under the Agreement (the "Existing Term Loan") in the principal amount equal to \$2,833,333.16. Borrower shall not request or receive any further advances under the Existing Term Loan. Interest shall continue to accrue on the Existing Term Loan at the rate specified in Section 2.3(a). Borrower shall continue to make payments on the Existing Term Loan in equal payments of principal plus all accrued interest each month in accordance with the Agreement until December 1, 2009, at which time all amounts due under this Section 2.1(b) shall be immediately due and payable. Advances under the Existing Term Loan, once repaid, may not be reborrowed. Borrower may prepay all advances under the Existing Term Loan without penalty or premium.

3. Section 2.1(c) is added to the Agreement to read as follows:

(c) Equipment Advances.

(i) Subject to and upon the terms and conditions of this Agreement, Bank agrees to make Equipment Advances to Borrower in three tranches, the Initial Equipment Advance as defined herein, Tranche A and Tranche B. Borrower may request an Equipment Advance at any time prior to March 15, 2007 (the "Initial Equipment Advance"). Borrower may request Tranche A Equipment Advances at any time from the date hereof through Tranche A Availability End Date. Borrower may request Tranche B Equipment Advances at any time from the day after the Tranche A Availability End Date through the Tranche B Availability End Date. The aggregate amount of the Initial Equipment Advance, Tranche A Equipment Advances and Tranche B Equipment Advances shall not exceed the Equipment Line. The Initial Equipment Advance shall not exceed 100% of the invoice amount of equipment and software purchased from June 1, 2006 through December 31, 2006. Each Tranche A Equipment Advance and Tranche B Equipment Advance shall not exceed 100% of the invoice amount of equipment and software approved by Bank from time to time (which Borrower shall, in any case, have purchased within 90 days of the date of the corresponding Equipment Advance), excluding taxes, shipping, warranty charges, freight discounts and installation expense; provided however, that up to 15% of the Initial Equipment Advance and the Equipment Advances may be used to finance software and other soft costs.

(ii) Interest shall accrue from the date of each Equipment Advance at the rate specified in Section 2.3(a), and shall be payable in accordance with Section 2.3(c). Any Equipment Advances that are outstanding under the Initial Equipment Advance on the Closing Date shall be payable in 48 equal monthly installments of principal, plus all accrued interest, beginning on March 28, 2007. Any Equipment Advances that are outstanding on the Tranche A Availability End Date shall be payable in 42 equal monthly installments of principal, plus all accrued interest, beginning on September 28, 2007, and continuing on the same day of each month thereafter through the Equipment Maturity Date, at which time all amounts due in connection with Tranche A Equipment Advance made under this Section 2.1(c) shall be immediately due and payable. Any Equipment Advances that are outstanding under Tranche B on the Tranche B Availability End Date shall be payable in 36 equal monthly installments of principal, plus all accrued interest, beginning on March 28, 2008, and continuing on the same day of each month thereafter through the Equipment Maturity Date, at which time all amounts due in connection with Tranche B Equipment Advance made under this Section 2.1(c) and any other amounts owing under this Agreement shall be immediately due and payable. Equipment Advances, once repaid, may not be reborrowed. Borrower may prepay any Equipment Advances without penalty or premium.

(iii) When Borrower desires to obtain an Equipment Advance, Borrower shall notify Bank (which notice shall be irrevocable) by facsimile transmission to be received no later than 3:00 p.m. Pacific time three Business Days before the day on which the Equipment Advance is to be made. Such notice shall be substantially in the form of Exhibit C. The notice shall be signed by a Responsible Officer or its designee and include a copy of the invoice for any Equipment to be financed.

4. Section 2.3(a)(iii) of the Agreement is amended in its entirety to read as follows:

(iii) Except as set forth in Section 2.3(b), the Equipment Advances shall bear interest, on the outstanding daily balance thereof, as set forth in the LIBOR Addendum to Loan & Security Agreement.

5. Section 6.3 of the Agreement is amended by adding a new paragraph at the end to read as follows:

Within thirty (30) days after the last day of each month, Borrower shall deliver to Bank a monthly backlog report.

6. Section 6.8 of the Agreement is amended in its entirety to read as follows:

**6.8 Financial Covenants.** Borrower shall at all times maintain the following financial ratios and covenants:

(a) Tangible Net Worth. A Tangible Net Worth of not less than \$4,000,000.

7. Exhibit D to the Agreement is amended and replaced in its entirety by Exhibit D attached hereto.

8. Exhibit E to the Agreement is deleted.

9. If any single project valued at \$750,000 or more be delayed for any reason, Borrower will notify Bank within five days to discuss the circumstances and Borrower's proposed plan as to that project.

10. Within 60 days after the date of the Amendment, Borrower shall obtain an appraisal on its existing equipment with results satisfactory to Bank.

11. Unless otherwise defined, all initially capitalized terms in this Amendment shall be as defined in the Agreement. The Agreement, as amended hereby shall be and remain in full force and effect in accordance with its terms and hereby is ratified and confirmed in all respects. Except as expressly set forth herein, the execution, delivery, and performance of this Amendment shall not operate as a waiver of, or as an amendment of, any right, power, or remedy of Bank under the Agreement, as in effect prior to the date hereof. Borrower ratifies and reaffirms the continuing effectiveness of all promissory notes, guaranties, security agreements, mortgages, deeds of trust, environmental agreements, and all other instruments, documents and agreements entered into in connection with the Agreement.

12. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument.

13. As a condition to the effectiveness of this Amendment, Bank shall have received, in form and substance satisfactory to Bank, the following:

(a) this Amendment, duly executed by Borrower;

(b) an officer's certificate of Borrower with respect to incumbency and resolutions authorizing the execution and delivery of this Amendment;

(c) a LIBOR Addendum to Loan and Security Agreement;

(d) an Affirmation of Guaranty, duly executed by Safeguard Delaware, Inc. and Safeguard Scientifics (Delaware), Inc.;

(e) a Guaranty, duly executed by Safeguard Scientifics, Inc. and resolutions authorizing the execution and delivery of the Guaranty;

(f) disbursement instructions and agreement to provide insurance;

(g) a nonrefundable commitment fee on account of the Equipment Line equal to \$5,000;

(h) a nonrefundable renewal fee on account of the Revolving Line equal to \$15,000 plus an amount equal to all Bank Expenses incurred through the date of this Amendment; and

(i) such other documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.  
IN WITNESS WHEREOF, the undersigned have executed this Amendment as of the first date above written.

LAUREATE PHARMA, INC.

By: /s/ Steve Grenfell

Title: Vice President

COMERICA BANK

By: /s/ Beth Kinsey

Title: Senior Vice President



**AMENDMENT AND AFFIRMATION OF GUARANTY**

This **AMENDMENT AND AFFIRMATION OF GUARANTY** is made as of February 28, 2007, by and among SAFEGUARD DELAWARE, INC. ("SDI"), SAFEGUARD SCIENTIFICS (DELAWARE), INC. ("SSI"; collectively with SDI, "Guarantors", each, a "Guarantor") and COMERICA BANK ("Bank").

**RECITALS**

Bank and LAUREATE PHARMA, INC. ("Borrower") are parties to that certain Loan and Security Agreement dated as of December 1, 2004, as amended, including without limitation by that certain First Amendment to Loan and Security Agreement dated as of January 31, 2005, that certain Second Amendment to Loan and Security Agreement dated as of May 6, 2005, that certain Third Amendment to Loan and Security Agreement dated as of June 20, 2005, that certain letter agreement dated as of January 28, 2006, that certain Fourth Amendment to Loan and Security Agreement dated as of February 28, 2006, that certain Fifth Amendment to Loan and Security Agreement dated as of August 2, 2006 (collectively, the "Loan Agreement"). Guarantors executed for the benefit of Bank an Unconditional Guaranty dated as of December 1, 2004, as amended from time to time, including by that certain Affirmation and Amendment of Guaranty dated as of May 6, 2005, that certain Affirmation and Amendment of Guaranty dated as of June 20, 2005, that certain Affirmation of Guaranty dated as of February 28, 2006, and that certain Affirmation of Guaranty dated as of August 2, 2006 (the "Guaranty"), guarantying amounts owing by Borrower to Bank. Borrower and Bank propose to enter into a Sixth Amendment to Loan and Security Agreement of even date herewith (the "Amendment"), which amends the Loan Agreement by, among other things, extending additional credit and extending the maturity date. Bank has agreed to enter into the Amendment provided, among other things, that each Guarantor consents to the Amendment and agrees that the Guaranty will remain effective. In addition, the parties desire to amend the Guaranty in accordance with the terms of this Amendment and Affirmation.

**AGREEMENT**

**NOW, THEREFORE**, each Guarantor agrees as follows:

1. The reference to \$9,500,000 in the first paragraph of the Guaranty is amended to read \$15,000,000.
2. Each Guarantor consents to the execution, delivery and performance by Borrower of the Amendment and the documents and instruments executed in connection therewith. The Guaranty is and shall remain in full force and effect with respect to Borrower's Obligations (as defined in the Loan Agreement) as modified by the Amendment and otherwise. Each Guarantor confirms that such Guarantor has no defenses against its obligations under the Guaranty.
3. The Guaranty, as amended, shall be and shall remain in full force and effect in accordance with its terms and hereby is ratified and confirmed in all respects. Except as expressly set forth herein, the execution, delivery, and performance of this Amendment and Affirmation shall not operate as a waiver of, or as an amendment of, any right, power, or remedy of Bank under the Guaranty, as in effect prior to the date hereof. Each Guarantor ratifies and reaffirms the continuing effectiveness of all instruments, documents and agreements entered into in connection with the Guaranty.
4. Each Guarantor represents and warrants that the Representations and Warranties contained in the Guaranty are true and correct as of the date of this Amendment and Affirmation. Unless otherwise defined, all capitalized terms in this Amendment and Affirmation shall be as defined in the Guaranty. This Amendment and Affirmation may be signed in two or more counterparts, each of which shall be deemed an original and all of which shall constitute one instrument.

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**IN WITNESS WHEREOF**, the undersigned have executed this Amendment and Affirmation of Guaranty as of the first date above written.

SAFEGUARD DELAWARE, INC.

By: /s/ Steven J. Feder

Title: Vice President

SAFEGUARD SCIENTIFICS (DELAWARE), INC.

By: /s/ Steven J. Feder

Title: Vice President

COMERICA BANK

By: /s/ Beth Kinsey

Title: Senior Vice President



DEFICIENCY GUARANTY

COMERICA BANK ("Bank") made one or more loans or provided credit facilities to LAUREATE PHARMA, INC. ("Borrower"), pursuant to a Loan and Security Agreement between Borrower and Bank dated as of December 1, 2004, as amended, including, without limitation, by that certain First Amendment to Loan and Security Agreement dated as of January 31, 2005, that certain Second Amendment to Loan and Security Agreement dated as of May 6, 2005, that certain Third Amendment to Loan and Security Agreement dated as of June 20, 2005, that certain letter agreement dated as of January 28, 2006, that certain Fourth Amendment to Loan and Security Agreement dated as of February 28, 2006, and that certain Fifth Amendment to Loan and Security Agreement dated as of August 2, 2006, as amended from time to time (the "Agreement"). Bank proposes to enter into that certain Sixth Amendment to Loan and Security Agreement dated as of the date hereof (the "Amendment"). Acknowledging that Bank would not enter into the Amendment without the benefit of this Guaranty, each of the undersigned guarantors (individually, a "Guarantor") hereby unconditionally, irrevocably, jointly and severally guarantees the prompt and complete payment of all amounts that Borrower owes to Bank in respect of the Equipment Advances, as defined in the Agreement, in accordance with its terms and subject to the limitations set forth herein. All terms used without definition in this Guaranty shall have the meaning assigned to them in the Agreement. Each Guarantor's maximum liability under this Guaranty shall not exceed a principal amount of \$6,000,000 plus interest and fees accrued in connection with the enforcement of the Agreement.

1. Guarantors shall pay all amounts due in connection with the Equipment Advances (including, without limitation, all principal, interest, and fees) upon demand by Bank in accordance with Section 2 hereof.

2. Each Guarantor's maximum liability under this Guaranty shall not exceed a principal amount of \$6,000,000 plus interest and fees accrued in connection with the enforcement of the Agreement. Furthermore, the guaranty evidenced hereby is a deficiency guaranty only. Bank may exercise its remedies hereunder as against the each Guarantor only (a) after having commenced taking commercially reasonable efforts to obtain payment from the Borrower and the other Credit Parties and realize on the collateral security granted in connection with the Agreement, and (b) for any such Obligations remaining outstanding beyond 90 days after (i) the date of such occurrence of an Event of Default under Section 8.1 (payment of principal or interest under the Agreement) of the Agreement that remains uncured after such 90 day period; or (ii) the acceleration of the Obligations which results from any other Event of Default that remains uncured after such 90 day period.

Notwithstanding the foregoing, Bank shall not be required to (i) continue to take any enforcement action after any proceeding under the Bankruptcy Code has been filed by or against Borrower, (ii) demand payment if Borrower has filed, or has had filed against it, a petition or other filing under the Bankruptcy Code that could operate to stay or otherwise restrict Bank from making such demand, or seek or obtain relief from any automatic stay under the Bankruptcy Code, (iii) take any enforcement action in contravention of any court order, injunction, law or governmental rule or regulation or contest any such court order, injunction, law or governmental rule or regulation, (iv) exercise any remedies with respect to Collateral (as defined in the Agreement), if Bank believes in good faith that the net amount which could reasonably be recovered from the Collateral does not justify the time, risks, cost, or expense involved, or (v) institute, intervene in or contest any suit or other legal proceedings.

3. The obligations hereunder are joint and several, are in addition to the obligations of Guarantors under the Guaranty dated as of December 1, 2004, as amended, and, subject to Section 2, are independent of the obligations of Borrower and any other person or entity, and a separate action or actions may be brought and prosecuted against a Guarantor whether action is brought against Borrower or whether Borrower be joined in any such action or actions. Each Guarantor waives the benefit of any statute of limitations affecting its liability hereunder or the enforcement thereof, to the extent permitted by law and subject to the limitations set forth in Section 2 above. A Guarantor's liability under this Guaranty is not conditioned or contingent upon the genuineness, validity, regularity or enforceability of the Agreement.

4. Each Guarantor authorizes Bank, without notice or demand and without affecting its liability hereunder, from time to time to (a) renew, extend, or otherwise change the terms of the Agreement or any part thereof; (b) take and hold security for the payment of this Guaranty or the Agreement, and exchange, enforce, waive

and release any such security; and (c) apply such security and direct the order or manner of sale thereof as Bank in its reasonable discretion may determine.

5. Subject to Section 2, each Guarantor waives any right to require Bank to (a) proceed against Borrower or any other person; (b) proceed against or exhaust any security held from Borrower; or (c) pursue any other remedy in Bank's power whatsoever. Subject to Section 2, Bank may, at its election, exercise or decline or fail to exercise any right or remedy it may have against Borrower or any security held by Bank, including without limitation the right to foreclose upon any such security by judicial or nonjudicial sale, without affecting or impairing in any way the liability of a Guarantor hereunder. Each Guarantor waives any defense arising by reason of any disability or other defense of Borrower or by reason of the cessation from any cause whatsoever of the liability of Borrower other than any defense of payment by Borrower or any other obligor. Each Guarantor waives any setoff, defense or counterclaim that it may have against Bank. Each Guarantor waives any defense arising out of the absence, impairment or loss of any right of reimbursement or subrogation or any other rights against Borrower. Until all of the amounts that Borrower owes to Bank have been paid in full, a Guarantor shall have no right of subrogation or reimbursement for claims arising out of or in connection with this Guaranty, contribution or other rights against Borrower, and such Guarantor waives any right to enforce any remedy that Bank now has or may hereafter have against Borrower. Each Guarantor waives all rights to participate in any security now or hereafter held by Bank. Each Guarantor waives all presentments, demands for performance, notices of nonperformance, protests, notices of protest, notices of dishonor, and notices of acceptance of this Guaranty and of the existence, creation, or incurring of new or additional indebtedness. Each Guarantor assumes the responsibility for being and keeping itself informed of the financial condition of Borrower and of all other circumstances bearing upon the risk of nonpayment of any indebtedness or nonperformance of any obligation of Borrower, warrants to Bank that it will keep so informed, and agrees that absent a request for particular information by such Guarantor, Bank shall have no duty to advise a Guarantor of information known to Bank regarding such condition or any such circumstances. Each Guarantor waives the benefits of California Civil Code sections 2809, 2810, 2819, 2845, 2847, 2848, 2849, 2850, 2899 and 3433.

6. Each Guarantor acknowledges that, to the extent Guarantor has or may have certain rights of subrogation or reimbursement against Borrower for claims arising out of this Guaranty, those rights may be impaired or destroyed if Bank elects to proceed against any real property security of Borrower by non-judicial foreclosure. That impairment or destruction could, under certain judicial cases and based on equitable principles of estoppel, give rise to a defense by Guarantor against its obligations under this Guaranty. Each Guarantor waives that defense and any others arising from Bank's election to pursue non-judicial foreclosure. Without limiting the generality of the foregoing, each Guarantor waives any and all benefits and defenses under California Code of Civil Procedure Sections 580a, 580b, 580d and 726, to the extent they are applicable.

7. If Borrower becomes insolvent or is adjudicated bankrupt or files a petition for reorganization, arrangement, composition or similar relief under any present or future provision of the United States Bankruptcy Code, or if such a petition is filed against Borrower, and in any such proceeding some or all of any indebtedness or obligations under the Agreement are terminated or rejected or any obligation of Borrower is modified or abrogated, or if Borrower's obligations are otherwise avoided for any reason, Guarantor agrees that Guarantor's liability hereunder shall not thereby be affected or modified and such liability shall continue in full force and effect as if no such action or proceeding had occurred. This Guaranty shall continue to be effective or be reinstated, as the case may be, if any payment must be returned by Bank upon the insolvency, bankruptcy or reorganization of Borrower, Guarantor, any other guarantor, or otherwise, as though such payment had not been made.

8. Each Guarantor agrees to pay a reasonable attorneys' fee and all other costs and expenses which may be incurred by Bank in the enforcement of this Guaranty. No terms or provisions of this Guaranty may be changed, waived, revoked or amended without Bank's prior written consent. Should any provision of this Guaranty be determined by a court of competent jurisdiction to be unenforceable, all of the other provisions shall remain effective. This Guaranty embodies the entire agreement among the parties hereto with respect to the matters set forth herein, and supersedes all prior agreements among the parties with respect to the matters set forth herein. No course of prior dealing among the parties, no usage of trade, and no parol or extrinsic evidence of any nature shall be used to supplement, modify or vary any of the terms hereof. There are no conditions to the full effectiveness of this Guaranty. Bank may assign this Guaranty together with the underlying indebtedness of Borrower, without in any way affecting Guarantor's liability under it. This Guaranty shall inure to the benefit of Bank and its successors and

assigns. This Guaranty is in addition to the guaranties of any other guarantors and any and all other guaranties of Borrower's indebtedness or liabilities to Bank.

9. Each Guarantor represents and warrants to Bank that (i) Guarantor has taken all necessary and appropriate corporate action to authorize the execution, delivery and performance of this Guaranty, (ii) execution, delivery and performance of this Guaranty do not conflict with or result in a breach of or constitute a default under Guarantor's Certificate of Incorporation or Bylaws or other organizational documents or agreements to which it is party or by which it is bound, and (iii) this Guaranty constitutes a valid and binding obligation, enforceable against Guarantor in accordance with its terms, except as such enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally and by general equitable principles (whether enforcement is sought by proceedings in equity or at law).

10. Each Guarantor covenants and agrees that such Guarantor shall do all of the following:

10.1 Guarantor shall maintain its corporate existence, remain in good standing in its state of formation, and continue to qualify in each jurisdiction in which the failure to so qualify could reasonably be expected to have a material adverse effect on the financial condition, operations or business of Guarantor. Guarantor shall maintain in force all licenses, approvals and Agreement, the loss of which could reasonably be expected to have a material adverse effect on its financial condition, operations or business.

10.2 Guarantor shall comply with all statutes, laws, ordinances, directives, orders, and government rules and regulations to which it is subject if non-compliance with such laws could adversely affect the financial condition, operations or business of Guarantor.

10.3 At any time and from time to time Guarantor shall execute and deliver such further instruments and take such further action as may reasonably be requested by Bank to effect the purposes of this Guaranty.

10.4 Guarantor shall not transfer, assign, encumber or otherwise dispose of any shares of capital stock or other equity interest Guarantor may now have or hereafter acquire in Borrower.

11. This Guaranty shall be governed by the laws of the State of California, without regard to conflicts of laws principles. Jurisdiction shall lie in the State of California. **UNDERSIGNED ACKNOWLEDGE THAT THE RIGHT TO TRIAL BY JURY IS A CONSTITUTIONAL ONE, BUT THAT IT MAY BE WAIVED UNDER CERTAIN CIRCUMSTANCES. TO THE EXTENT PERMITTED BY LAW, EACH PARTY, AFTER CONSULTING (OR HAVING HAD THE OPPORTUNITY TO CONSULT) WITH COUNSEL OF ITS, HIS OR HER CHOICE, KNOWINGLY AND VOLUNTARILY, AND FOR THE MUTUAL BENEFIT OF ALL PARTIES, WAIVES ANY RIGHT TO TRIAL BY JURY IN THE EVENT OF LITIGATION ARISING OUT OF OR RELATED TO THIS GUARANTY OR ANY OTHER DOCUMENT, INSTRUMENT OR AGREEMENT BETWEEN THE UNDERSIGNED PARTIES.**

12. REFERENCE PROVISION.

12.1 In the event the Jury Trial Waiver set forth above is not enforceable, the parties elect to proceed under this Judicial Reference Provision.

12.2 With the exception of the items specified in clause 12.3, below, any controversy, dispute or claim (each, a "Claim") between the parties arising out of or relating to this Agreement or any other document, instrument or agreement between the undersigned parties (collectively in this Section, the "Loan Documents"), will be resolved by a reference proceeding in California in accordance with the provisions of Sections 638 et seq. of the California Code of Civil Procedure ("CCP"), or their successor sections, which shall constitute the exclusive remedy for the resolution of any Claim, including whether the Claim is subject to the reference proceeding. Except as otherwise provided in the Loan Documents, venue for the reference proceeding will be in the Superior Court in the County where the real property involved in the action, if any, is located or in a County where venue is otherwise appropriate under applicable law (the "Court").

12.3 The matters that shall not be subject to a reference are the following: (i) nonjudicial foreclosure of any security interests in real or personal property, (ii) exercise of self-help remedies (including, without limitation, set-off), (iii) appointment of a receiver and (iv) temporary, provisional or ancillary remedies (including, without limitation, writs of attachment, writs of possession, temporary restraining orders or preliminary injunctions). This Agreement does not limit the right of any party to exercise or oppose any of the rights and remedies described in clauses (i) and (ii) or to seek or oppose from a court of competent jurisdiction any of the items described in clauses (iii) and (iv). The exercise of, or opposition to, any of those items does not waive the right of any party to a reference pursuant to this Agreement.

12.4 The referee shall be a retired Judge or Justice selected by mutual written agreement of the parties. If the parties do not agree within ten (10) days of a written request to do so by any party, then, upon request of any party, the referee shall be selected by the Presiding Judge of the Court (or his or her representative). A request for appointment of a referee may be heard on an ex parte or expedited basis, and the parties agree that irreparable harm would result if ex parte relief is not granted.

12.5 The parties agree that time is of the essence in conducting the reference proceedings. Accordingly, the referee shall be requested, subject to change in the time periods specified herein for good cause shown, to (i) set the matter for a status and trial-setting conference within fifteen (15) days after the date of selection of the referee, (ii) if practicable, try all issues of law or fact within one hundred twenty (120) days after the date of the conference and (iii) report a statement of decision within twenty (20) days after the matter has been submitted for decision.

12.6 The referee will have power to expand or limit the amount and duration of discovery. The referee may set or extend discovery deadlines or cutoffs for good cause, including a party's failure to provide requested discovery for any reason whatsoever. Unless otherwise ordered based upon good cause shown, no party shall be entitled to "priority" in conducting discovery, depositions may be taken by either party upon seven (7) days written notice, and all other discovery shall be responded to within fifteen (15) days after service. All disputes relating to discovery which cannot be resolved by the parties shall be submitted to the referee whose decision shall be final and binding.

12.7 Except as expressly set forth in this Agreement, the referee shall determine the manner in which the reference proceeding is conducted including the time and place of hearings, the order of presentation of evidence, and all other questions that arise with respect to the course of the reference proceeding. All proceedings and hearings conducted before the referee, except for trial, shall be conducted without a court reporter, except that when any party so requests, a court reporter will be used at any hearing conducted before the referee, and the referee will be provided a courtesy copy of the transcript. The party making such a request shall have the obligation to arrange for and pay the court reporter. Subject to the referee's power to award costs to the prevailing party, the parties will equally share the cost of the referee and the court reporter at trial.

12.8 The referee shall be required to determine all issues in accordance with existing case law and the statutory laws of the State of California. The rules of evidence applicable to proceedings at law in the State of California will be applicable to the reference proceeding. The referee shall be empowered to enter equitable as well as legal relief, enter equitable orders that will be binding on the parties and rule on any motion which would be authorized in a court proceeding, including without limitation motions for summary judgment or summary adjudication. The referee shall issue a decision at the close of the reference proceeding which disposes of all claims of the parties that are the subject of the reference. Pursuant to CCP § 644, such decision shall be entered by the Court as a judgment or an order in the same manner as if the action had been tried by the Court and any such decision will be final, binding and conclusive. The parties reserve the right to appeal from the final judgment or order or from any appealable decision or order entered by the referee. The parties reserve the right to findings of fact, conclusions of laws, a written statement of decision, and the right to move for a new trial or a different judgment, which new trial, if granted, is also to be a reference proceeding under this provision.

12.9 If the enabling legislation which provides for appointment of a referee is repealed (and no successor statute is enacted), any dispute between the parties that would otherwise be determined by reference procedure will be resolved and determined by arbitration. The arbitration will be conducted by a retired judge or Justice, in accordance with the California Arbitration Act §1280 through §1294.2 of the CCP as amended from time

to time. The limitations with respect to discovery set forth above shall apply to any such arbitration proceeding.

12.10 THE PARTIES RECOGNIZE AND AGREE THAT ALL CONTROVERSIES, DISPUTES AND CLAIMS RESOLVED UNDER THIS REFERENCE PROVISION WILL BE DECIDED BY A REFEREE AND NOT BY A JURY. AFTER CONSULTING (OR HAVING HAD THE OPPORTUNITY TO CONSULT) WITH COUNSEL OF ITS, HIS OR HER OWN CHOICE, EACH PARTY KNOWINGLY AND VOLUNTARILY, AND FOR THE MUTUAL BENEFIT OF ALL PARTIES, AGREES THAT THIS REFERENCE PROVISION WILL APPLY TO ANY CONTROVERSY, DISPUTE OR CLAIM BETWEEN OR AMONG THEM ARISING OUT OF OR IN ANY WAY RELATED TO, THIS AGREEMENT OR THE OTHER LOAN DOCUMENTS.

IN WITNESS WHEREOF, the undersigned Guarantor has executed this Guaranty as of this 28th day of February, 2007.

SAFEGUARD DELAWARE, INC.

By: /s/ Steven J. Feder  
Title: Vice President

SAFEGUARD SCIENTIFICS (DELAWARE), INC.

By: /s/ Steven J. Feder  
Title: Vice President

Safeguard Delaware, Inc. and Safeguard  
Scientifics (Delaware), Inc.  
Attn: CFO  
800 The Safeguard Building  
435 Devon Park Drive  
Wayne, PA 19087



**SAFEGUARD SCIENTIFICS, INC.  
CODE OF BUSINESS CONDUCT AND ETHICS**

**I. Background — Administration**

The reputation and integrity of Safeguard Scientifics, Inc. (“Company”) is a valuable asset that is vital to our success.

Each Company employee, including each of the Company’s officers, and each Company director is responsible for conducting the Company’s business in a manner that demonstrates a commitment to the highest standards of integrity. This Code of Business Conduct and Ethics (“Code”), which applies to all directors, officers and employees of the Company (collectively referred to as “Company Personnel”), has been adopted to help Company Personnel meet these standards. Specifically, the purpose of this Code is to:

- encourage among Company Personnel a culture of honesty, accountability and mutual respect;
- provide guidance to help Company Personnel recognize and deal with ethical issues; and
- provide mechanisms for Company Personnel to report unethical conduct.

While this Code is designed to provide helpful guidelines, it is not intended to address every specific situation. Nevertheless, in every instance, we require that Company Personnel act honestly, fairly and with a view towards “doing the right thing.”

The Safeguard Scientifics, Inc. Board of Directors (“Safeguard Board”) is ultimately responsible for the implementation of the Code. The Safeguard Board has designated Steven J. Feder to be the compliance officer (the “Compliance Officer”) for the implementation and administration of the Code. Company Personnel should feel free to direct questions concerning this Code to the Compliance Officer:

Safeguard Scientifics, Inc.  
Attention: Compliance Officer  
800 The Safeguard Building  
435 Devon Park Drive  
Wayne, PA 19087-1945  
e-mail address: [complianceofficer@safeguard.com](mailto:complianceofficer@safeguard.com)

**II. Overview**

It is the policy of the Company to: (a) comply with all applicable governmental laws, rules and regulations; (b) expect that all Company Personnel at all times observe honest and ethical conduct in the performance of their responsibilities, including the avoidance of conflicts of interest; (c) expect all Company Personnel to treat others with dignity, including other employees, shareholders, customers and vendors; and (d) encourage and support internal disclosure of any violation of this Code for appropriate action.

The Code governs the business-related conduct of all Company Personnel, including, but not limited to, the chief executive officer, chief financial officer and all other officers of Safeguard. Directors of the Company who are not employees are subject to this Code only as it relates to their capacities as directors.

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### **III. Compliance With Law**

A variety of laws apply to the Company and its operations. Company Personnel are expected to comply with all such laws, as well as rules and regulations adopted under such laws. Examples of criminal violations under these laws include:

- stealing, embezzling or misapplying corporate or bank funds;
- using threats, physical force or other unauthorized means to collect money;
- making false entries in the books and records of the Company, or engaging in any conduct that results in the making of such false entries;
- making a payment for an expressed purpose on the Company's behalf to an individual who intends to use it for a different purpose;
- utilizing the Company's funds or other assets or services to make a political contribution or expenditure; and
- making payments, whether corporate or personal, of cash or other items of value that are intended to influence the judgment or actions of political candidates, government officials or businesses in connection with any of the Company's activities.

The Company must and will report all suspected criminal violations to the appropriate authorities for possible prosecution and will investigate, address and report to governmental or other authorities, as appropriate, non-criminal violations.

### **IV. Conflicts of Interest**

Company Personnel are expected to make or participate in business decisions and actions in the course of their employment with the Company based on the best interests of the Company as a whole, and not based on personal relationships or personal benefits. A conflict of interest, which can occur or appear to occur in a wide variety of situations, can compromise the business ethics of Company Personnel. Generally speaking, a conflict of interest occurs when the personal interest of Company Personnel or members of their immediate family interferes with, or has the potential to interfere with, the interests or business of the Company. For example, a conflict of interest may occur where an employee or a family member receives a gift, a unique advantage, or an improper personal benefit as a result of the employee's position at the Company. A conflict of interest could make it difficult for such person to perform corporate duties objectively and effectively because he or she is involved in a competing interest. The following is a discussion of certain common areas that raise conflict of interest issues. However, a conflict of interest can occur in a variety of situations. Company Personnel must be alert to recognize any situation that may raise conflict of interest issues and must disclose to the Compliance Officer any material transaction or relationship that reasonably could be expected to give rise to actual or apparent conflicts of interest with the Company.

***Outside Activities/Employment*** – Any outside activity must not significantly encroach on the time and attention Company Personnel devote to their corporate duties and should not adversely affect the quality or quantity of their work. In addition, Company Personnel may not make use of corporate equipment, facilities or supplies, or imply (without the Company's approval) the Company's sponsorship or endorsement of any outside activity, and under no circumstances are Company Personnel permitted to take for themselves or their family members business opportunities that are discovered or made available by virtue of their positions at the Company. Moreover, Company Personnel may not perform services for or, except as noted in the following paragraph, have a financial interest in any entity that is or to such person's knowledge may become, a vendor, customer or competitor of the Company. Company

employees are prohibited from taking part in any outside employment without Safeguard's prior written approval.

Company employees generally may have a passive investment in up to five percent of the total outstanding shares of an entity that is listed on a national or international exchange, or quoted on Nasdaq, the OTC Bulletin Board or a similar quotation service, provided that the investment is not so large financially either in absolute dollars or as a percentage of the person's total net worth that it creates the appearance of a conflict of interest.

Directors of the Company who are not employees of the Company must be sensitive to situations in which they may be associated with, or have business or financial interests in, corporations or other business entities that, from time to time, have business dealings with the Company or which may compete with the Company. While these relationships and interests are not prohibited, they should be avoided where reasonably practicable. Any Company director who becomes engaged in such a relationship or interest must promptly bring it to the attention of the Chairperson of the Safeguard Board. The Chairperson shall promptly refer such matter to the full Safeguard Board or an appropriately authorized committee of the Safeguard Board for consideration and appropriate disposition. If a conflict cannot be avoided, it must be managed in an ethical and responsible manner.

***Civic/Political Activities*** – Company Personnel are encouraged to participate in civic, charitable or political activities so long as such participation does not encroach on the time and attention they are expected to devote to their Company-related duties. Such activities are to be conducted in a manner that does not involve the Company or its assets or facilities and does not create an appearance of the Company's sponsorship or endorsement.

***Inventions, Books and Publications*** – Company employees must receive written permission from the Compliance Officer before developing, outside of the Company, any products, software or intellectual property that may be related to the Company's current or potential business.

***Proper Payments*** – Company Personnel should pay for and receive only that which is proper. Company Personnel should not make or promise payments to influence another's acts or decisions, and Company employees must not give gifts beyond those extended in normal business.

***Gifts*** – Company Personnel and members of their families must not give or receive valuable gifts (including gifts of equipment or money, discounts, or favored personal treatment) to or from any person associated with Safeguard's vendors or customers. Acceptance of a gift in the nature of a memento, such as a conference gift or other inconsequential gift valued at less than one hundred dollars (\$100), is permitted. Engaging in normal occasional business-related entertainment, such as meals or the use of sporting, theatrical or other public event tickets, is permissible with the understanding that it is expected that Company Personnel will exercise sound judgment in reliance on this exception so as to avoid any situation that may otherwise be subject to question.

***Loans to Directors and Employees*** – The Company will not make loans or extend credit guarantees to or for the personal benefit of directors and executive officers except as permitted by law and the listing standards of any exchange or quotation system on which the Company's common stock is listed. Loans or guarantees may be extended to other employees only with the Company's approval.

***Insider Trading*** – Company Personnel are prohibited from trading in securities while in possession of material inside information. Among other things, trading while in possession of material inside information can subject the person to criminal or civil penalties. The Company has adopted a Statement of Company Policy for Securities Trading by Company Personnel (the "Insider Trading Policy") and

requires all Company Personnel to sign a statement acknowledging that they have read, understand and will comply with the policies set forth therein.

#### **V. Fair Dealing**

Company Personnel should deal fairly and in good faith with each other and the Company's customers, suppliers, regulators, business partners and others. Company Personnel may not take unfair advantage of anyone through manipulation, misrepresentation, inappropriate threats, fraud, abuse of confidential information or other related conduct.

#### **VI. Proper Use of Company Assets**

Company assets, including facilities, materials, supplies, time, information, intellectual property, software, and other assets owned or leased by the Company, or that are otherwise in the Company's possession, may be used only for legitimate business purposes. The personal use of the Company's assets without the Company's approval is prohibited.

#### **VII. Delegation of Authority**

Company Personnel, and particularly each of the Company's officers and other managerial employees, must exercise due care to ensure that any delegation of authority is reasonable and appropriate in scope and includes appropriate and continuous monitoring.

#### **VIII. Handling Confidential Information**

Company Personnel should observe the confidentiality of information that they acquire by virtue of their affiliation with or employment by the Company, including information concerning customers, vendors, competitors and other employees, except where disclosure is approved by the Company or otherwise legally mandated. Of special sensitivity is financial information, which should under all circumstances be considered confidential except where its disclosure is approved by the Company, or after one full business day following its disclosure in a press release or a report filed with the SEC. In addition, Company Personnel must safeguard proprietary information, which includes information that is not generally known to the public and has commercial value in the Company's business. Proprietary information includes, among other things, software programs, source and object codes, trade secrets, ideas, techniques, inventions (whether patentable or not) and other information relating to designs, algorithms and research. It also includes information relating to marketing, pricing, customers, and terms of compensation for Company Personnel. The obligation to safeguard proprietary information continues even after employment ends.

#### **IX. Books and Records; Public Disclosures**

The effective operation of the Company's business, and the integrity of the Company's public disclosures, is dependent on accurate business records. Company personnel must prepare and maintain all Company records accurately and honestly. Company Personnel may not knowingly or recklessly make any false or misleading entries in any books, records or accounts of the Company, and no Company funds may be used for any purpose other than as described in the documents supporting the disbursement.

As a public company, the Company has an additional obligation to make or keep books, records and accounts that accurately and fairly reflect Company transactions so that filings and submissions with the SEC and other public communications provide full, fair, timely, accurate and understandable disclosure. Company Personnel engaged in the preparation of these filings, submissions and communications

("Public Disclosure Personnel") must endeavor to ensure that the Company's filings, submissions, and communications meet these objectives. Depending on their duties and responsibilities, other employees may be called upon to provide information to assure that the Company's reports are complete, fair and understandable. Company Personnel are expected to take this responsibility very seriously. If requested by Public Disclosure Personnel to provide information for use in such filings, submissions or communications, Company Personnel will provide, as promptly as practicable, accurate, understandable and complete information on a timely basis.

Company employees who are responsible for any aspect of our internal accounting controls and financial and tax reporting systems must be vigilant in recording entries accurately and honestly and in a manner consistent with all legal requirements. If you are uncertain about proper recording of Company transactions or accounting or tax matters, you should consult with a superior. Company Personnel must not take any action to fraudulently influence, coerce, manipulate or mislead any auditor engaged in the performance of an audit of Company financial statements. Complaints or concerns regarding accounting, internal accounting controls or auditing matters should be reported either to the Compliance Officer or to the Audit Committee of the Safeguard Board as indicated in Article X of this Code. You may choose to submit such complaints or concerns anonymously.

## **X. Report of Violations**

**Administration – General Policy Regarding Report of Violations** – Company Personnel who observe, learn of, or, in good faith, suspect a violation of the Code must immediately report the violation either to his or her immediate supervisor (who in turn is responsible for informing the Compliance Officer of such report) or to the Compliance Officer (or, in connection with complaints or concerns regarding accounting, internal accounting controls or audit matters, may report the violation to the Audit Committee of the Safeguard Board). You may be subject to disciplinary action, including termination of employment, for failure to do so.

### **Complaint Procedure**

- **Notification of Complaint**

- To report a violation or a suspected violation to the Compliance Officer, provide the report to the following address or e-mail address:

Safeguard Scientifics, Inc.  
Attention: Compliance Officer  
800 The Safeguard Building  
435 Devon Park Drive  
Wayne, PA 19087-1945  
e-mail: [complianceofficer@safeguard.com](mailto:complianceofficer@safeguard.com)

- Complaints or concerns regarding accounting, internal accounting controls or auditing matters may also be submitted anonymously to the Audit Committee of the Safeguard Board in writing at the following address:

Safeguard Scientifics, Inc.  
Attention: Chair, Audit Committee — CONFIDENTIAL  
c/o Corporate Secretary  
800 The Safeguard Building  
435 Devon Park Drive  
Wayne, PA 19087-1945

- Whenever practical, the complaint should be made in writing. It is unacceptable to submit a complaint knowing it is false.
- Company Personnel who are not comfortable using the procedures and protocols outlined above can make an anonymous report via our third party provider, MySafeWorkplace. This anonymous and confidential reporting system is not affiliated with the Company and is accessible 24/7 through the Internet ([www.MySafeWorkplace.com](http://www.MySafeWorkplace.com)) or by calling the toll free number (800.461.9330).
- Investigation and Corrective Action

Reports of violations will promptly be investigated under the supervision of the Compliance Officer or, if appropriate, the Audit Committee. Company personnel are required to cooperate fully in the investigation of reported violations and to provide truthful, complete and accurate information. The investigation will be handled as discreetly as reasonably possible, allowing for a fair investigation and any necessary corrective action. Appropriate corrective action will be taken whenever a violation of this policy is determined to have occurred. Depending on the nature of the violation, the offending individual can be subject to disciplinary action which may include termination. In addition, anyone who interferes with an investigation, or provides information in an investigation that the individual knows to be untrue or inaccurate, will be subject to disciplinary action, which may include termination of employment. Retaliation against employees who, for lawful purposes, file a complaint or participate in an investigation is strictly prohibited.

- Confidentiality

Except as may be required by law or by the requirements of the resulting investigation or the corrective action, all notices, reports and information received under this process will be treated in a confidential manner. Every reasonable effort will be made to handle the matter with discretion and to protect the identity of those who make reports as well as those who are being investigated. However, the Compliance Officer regularly will report to the Audit Committee any violations that have been reported. Further, if necessary to conduct a proper review or to comply with legal requirements, our Audit Committee, independent accountants or others may become involved in the review process. Also, as noted above, the Company must and will report all suspected criminal violations to the appropriate authorities for possible prosecution and will investigate, address and report to governmental or other authorities, as appropriate, non-criminal violations.

## **XI. Protection Against Retaliation**

**Policy** — The Company prohibits any form of retaliation against employees who, for lawful purposes, report to the Company any conduct or activity that may violate this Code, any law or regulation applicable to the Company, or any other suspected improper, unethical or illegal conduct or activities by anyone at the Company. The Company also prohibits any form of retaliation against employees who provide information, cause information to be provided, or assist in an investigation conducted by the Company or any governmental body regarding a possible violation of any law or regulation relating to fraud, any labor law, or any rule or regulation of the U.S. Securities and Exchange Commission, or who file, cause to be filed, or assist, participate or give testimony in any proceeding relating to an alleged violation of any such law, rule or regulation.

**Management Responsibility** — All Company officers and other managerial employees are responsible for ensuring adherence to this policy. In addition, each Company officer and managerial employee is responsible for communicating this policy to employees under his or her supervision and for supporting programs and practices designed to develop understanding of, commitment to and compliance with this policy. In the event that any Company officer, other managerial employee or supervisor believes that a violation of this policy has occurred or receives a report of a violation, he or she must immediately contact the Compliance Officer.

**Procedures for Reporting Policy Violations** — If an employee believes that he or she has been retaliated against (including threatened or harassed) in violation of this policy, he or she should immediately report the retaliation either to his or her immediate supervisor (who in turn is responsible for informing the Compliance Officer of such report) or to the Compliance Officer in accordance with the contact procedures for the Compliance Officer set forth above (or, in connection with retaliation related to complaints or concerns regarding accounting, internal accounting controls or audit matters, may report the violation to the Audit Committee of the Safeguard Board in accordance with the contact procedures for the Audit Committee set forth above). Any employee who is not comfortable using the procedures and protocols outlined above can make an anonymous report via our third party provider, MySafeWorkplace. This anonymous and confidential reporting system is not affiliated with the Company and is accessible 24/7 through the Internet ([www.MySafeWorkplace.com](http://www.MySafeWorkplace.com)) or by calling the toll free number (800.461.9330). Once an employee reports retaliation prohibited by this policy, the Company will promptly investigate the matter in accordance with the procedures described in Article X of this Code.

## **XII. Waivers**

Requests for a waiver of a provision of the Code must be submitted in writing to the Compliance Officer for appropriate review, and an executive officer of Safeguard Scientifics, Inc., the Safeguard Board or an appropriate Safeguard Board committee will decide the outcome. For conduct involving directors and executive officers, only the Audit Committee of the Safeguard Board has the authority to waive a provision of the Code. The Audit Committee of the Safeguard Board must review and approve any “related party” transaction as defined in Item 404 of Regulation S-K, promulgated by the SEC, before it is consummated. In the event of an approved waiver involving the conduct of a director or executive officer, appropriate and prompt disclosure must be made to the Company’s shareholders as required by the SEC or other regulation or by applicable listing standards of the principal exchange or interdealer quotation system on which the Company’s common stock is listed.

Statements in the Code to the effect that certain actions may be taken only with “the Company’s approval” or that certain items will be “designated by the Company” will be interpreted to mean that appropriate executive officers of Safeguard Scientifics, Inc. or members of the Safeguard Board must give

prior written approval or make such designation before the proposed action may be undertaken or the proposed designation may be made.

### **XIII. Compliance**

**Adherence to Code; Disciplinary Action** – All Company Personnel have a responsibility to understand and follow this Code. In addition, all Company Personnel are expected to perform their work with honesty and integrity in all areas not specifically addressed in this Code. A violation of this policy or the Code may result in appropriate disciplinary action, including the possible termination from employment with the Company.

**Communications; Training; Annual Certification** – The Company strongly encourages dialogue among employees and their supervisors to make everyone aware of situations that give rise to ethical questions and to articulate acceptable ways of handling those situations. Company employees will receive periodic training on the contents and importance of the Code and related policies and the manner in which violations must be reported and waivers must be requested. All Company Personnel must certify that they have read this Code and to the best of their knowledge are in compliance with all its provisions. In addition, each director, officer and other managerial employee of the Company, as may be designated by the Company from time to time, has an obligation to annually certify that he or she has read and reviewed this Code with his or her subordinates. Forms of these certifications are attached to this Code as Appendices I and II.

**Responsibility of Senior Employees** – All Company officers and other managerial employees will be responsible for the enforcement of, and compliance with, this Code, including necessary distribution to assure Company employee knowledge and compliance. Directors, officers and other managerial employees are expected to promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships. Managerial employees may be disciplined if they condone misconduct, do not report misconduct, do not take reasonable measures to detect misconduct, or do not demonstrate the appropriate leadership to insure compliance.

### **XIV. Related Policies; Enforceable by Company Only**

This Code should be read in conjunction with Safeguard's other policy statements , including but not limited to the Statement of Company Policy on Securities Trading by Company Personnel. This Code is for the benefit of the Company, and no other person or entity is entitled to enforce this Code. This Code does not, and should not be interpreted to, create any private cause of action or remedy in any other person or entity for a violation of the Code. In addition, this Code should not be construed as a contract of employment and does not change any person's employment status.

October 25, 2006

## APPENDIX I

### INITIAL CODE OF BUSINESS CONDUCT AND ETHICS DISCLOSURE STATEMENT

As a director, officer or other employee of Safeguard Scientifics, Inc. (“Company”), I have read and understand the Company’s Code of Business Conduct and Ethics (“Code”), and I hereby affirm my agreement to comply with its terms. I hereby certify as follows:

1. I have received a copy of the Code.
2. I have read, understand and agree to comply with the Code.
3. I am currently in compliance and, as applicable, members of my family are in compliance, with the terms of the Code and all obligations imposed by it, except as disclosed to the Compliance Officer or as otherwise disclosed in accordance with the procedures contained in Article X of the Code.
4. I am not aware of any conduct on the part of any person associated with the Company that may constitute a violation of the Code, except with respect to any matters that I may have disclosed to the Compliance Officer or otherwise disclosed in accordance with the procedures contained in Article X of the Code.
5. I understand that none of the benefits, policies, programs, procedures or statements in the Code are intended to confer any rights or privileges upon me or entitle me to be or remain an employee of the Company. I am aware that the Code is not a contract and is subject to change at any time, without notice, at the sole discretion of the Company.

I understand that all Disclosure Statements may be available to the Compliance Officer, the Company’s Board of Directors, and internal and external legal counsel. Such information shall otherwise be held in confidence in accordance with Article X of the Code.

**Each person signing a Disclosure Statement is responsible for keeping his/her Disclosure Statement current.** These statements will be kept in Safeguard’s Legal Department.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Name

\_\_\_\_\_  
Date

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## APPENDIX II

### ANNUAL CODE OF BUSINESS CONDUCT AND ETHICS DISCLOSURE STATEMENT

As a director, officer or other employee of Safeguard Scientifics, Inc. (“Company”), I have read and understand the Company’s Code of Business Conduct and Ethics (“Code”), and I hereby reaffirm my agreement to comply with its terms. With respect to the last 12 months, I hereby certify as follows:

1. I have complied and, as applicable, members of my family have complied, with the terms of the Code and all obligations imposed by it, except as disclosed to the Compliance Officer or as otherwise disclosed in accordance with the procedures contained in Article X of the Code.
2. I have read and reviewed the Code with my subordinates and I am not aware of any conduct on the part of any person associated with the Company that may constitute a violation of the Code of Conduct, except with respect to any matters that I may have disclosed to the Compliance Officer or otherwise disclosed in accordance with the procedures contained in Article X of the Code.
3. I understand that none of the benefits, policies, programs, procedures or statements in the Code are intended to confer any rights or privileges upon me or entitle me to be or remain an employee of the Company. I am aware that the Code is not a contract and is subject to change at any time, without notice, at the sole discretion of the Company.

I understand that all Disclosure Statements may be available to the Compliance Officer, the Company’s Board of Directors, and internal and external legal counsel. Such information shall otherwise be held in confidence except in accordance with Article X of the Code.

**Each person signing a Disclosure Statement is responsible for keeping his/her Disclosure Statement current.** These statements will be kept in Safeguard’s Legal Department.

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Signature

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Name

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Date



**SUBSIDIARIES OF SAFEGUARD SCIENTIFICS, INC.**

Exclusive of immaterial subsidiaries and companies in which the Registrant holds a minority interest, as of March 22, 2007, the Registrant had the following subsidiaries:

<u>NAME</u>	<u>PLACE OF INCORPORATION</u>
Acsis, Inc.	DELAWARE
Alliance Consulting Group Associates, Inc.	NEW JERSEY
Alliance Holdings, Inc.	DELAWARE
Alliance IT Consulting India Private Limited	INDIA
Bonfield Fund Management, L.P.	DELAWARE
Bonfield VII, Ltd.	BRITISH VIRGIN ISLANDS
Bonfield Partners Capital, L.P.	DELAWARE
ChromaServices, Inc.	DELAWARE
Clariant Diagnostic Services, Inc.	DELAWARE
Clariant, Inc.	DELAWARE
Laureate Pharma, Inc.	DELAWARE
Mensamind, Inc.	ILLINOIS
Pacific Title & Art Studio, Inc.	DELAWARE
Safeguard 99 Capital, L.P.	DELAWARE
Safeguard 2000 Capital, L.P.	DELAWARE
Safeguard 2001 Capital, L.P.	DELAWARE
Safeguard Capital Management, Inc.	DELAWARE
Safeguard Delaware, Inc.	DELAWARE
Safeguard Fund Management, Inc.	DELAWARE
Safeguard Fund Management, L.P.	DELAWARE
Safeguard Partners Capital, L.P.	DELAWARE
Safeguard Scientifics (Delaware), Inc.	DELAWARE
Safeguard Scientifics Foundation	PENNSYLVANIA
Safeguard Technologies, Inc.	DELAWARE
SSI Management Company, Inc.	DELAWARE
SSI Partnership Holdings (Pennsylvania), Inc.	PENNSYLVANIA



**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors  
Safeguard Scientifics, Inc.:

We consent to the incorporation by reference in the registration statements (Nos. 33-41853, 33-72560, 333-75501, 333-86777, 333-65092, 333-73284, 333-103976, 333-118046 and 333-129617) on Form S-8 and in the registration statements (Nos. 333-114794, 333-86675 and 333-32512) on Form S-3 of Safeguard Scientifics, Inc. and subsidiaries of our reports dated March 27, 2007, with respect to the consolidated balance sheets of Safeguard Scientifics, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive loss, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2006, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 and the effectiveness of internal control over financial reporting as of December 31, 2006, which reports appear in the December 31, 2006 annual report on Form 10-K of Safeguard Scientifics, Inc.

Our report with respect to the consolidated financial statements of Safeguard Scientifics, Inc. as of December 31, 2006 and 2005 and for each of the years in the three-year period ended December 31, 2006 contains an explanatory paragraph regarding the adoption of SFAS No. 123R, "Share-Based Payments," on January 1, 2006.

/s/ KPMG LLP

Philadelphia, Pennsylvania  
March 27, 2007



**CERTIFICATION**

I, Peter J. Boni, certify that:

1. I have reviewed this Annual Report on Form 10-K of Safeguard Scientifics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

SAFEGUARD SCIENTIFICS, INC.

PETER J. BONI

Peter J. Boni

*President and Chief Executive Officer*

Date: March 27, 2007



**CERTIFICATION**

I, Stephen T. Zarrilli, certify that:

1. I have reviewed this Annual Report on Form 10-K of Safeguard Scientifics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

SAFEGUARD SCIENTIFICS, INC.

STEPHEN T. ZARRILLI

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

Date: March 27, 2007



**Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906  
of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report of Safeguard Scientifics, Inc. (“Safeguard”) on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Peter J. Boni, President and Chief Executive Officer of Safeguard, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934, (15 U.S.C. 78m(a)); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Safeguard.

SAFEGUARD SCIENTIFICS, INC.

PETER J. BONI

\_\_\_\_\_  
Peter J. Boni

*President and Chief Executive Officer*

Date: March 27, 2007



**Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906  
of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report of Safeguard Scientifics, Inc. (“Safeguard”) on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Stephen T. Zarrilli, Acting Senior Vice President, Acting Chief Administrative Officer and Acting Chief Financial Officer of Safeguard, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934, (15 U.S.C. 78m(a)); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Safeguard.

SAFEGUARD SCIENTIFICS, INC.

STEPHEN T. ZARRILLI

Stephen T. Zarrilli

*Acting Senior Vice President, Acting Chief  
Administrative Officer and Acting Chief Financial  
Officer*

Date: March 27, 2007