# SAFEGUARD SCIENTIFICS INC

## FORM 10-Q
(Quarterly Report)

Filed 11/17/98 for the Period Ending 09/30/98

| | |
|---|---|
| Address | 435 DEVON PARK DR<br>BLDG 800<br>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-Q
(Quarterly Report)

### Filed 11/16/1998 For Period Ending 9/30/1998

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

# FORM 10-Q
# SECURITIES AND EXCHANGE COMMISSION
## WASHINGTON, DC 20549

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

**For Quarter Ended September 30, 1998 Commission File Number 1-5620**

# SAFEGUARD SCIENTIFICS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Pennsylvania | 23-1609753 |
| (state or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| 800 The Safeguard Building, 435 Devon Park Drive Wayne, PA | 19087 |
| (Address of principal executive offices) | (Zip Code) |
| Registrant's telephone number, including area code | (610) 293-0600 |

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

Yes X No

| | |
|---|---|
| Number of shares outstanding as of | November 12, 1998 |
| Common Stock | 31,582,947 |

# SAFEGUARD SCIENTIFICS, INC.
# QUARTERLY REPORT FORM 10-Q

## INDEX

## PART I - FINANCIAL INFORMATION



## PART II - OTHER INFORMATION

# SAFEGUARD SCIENTIFICS, INC.
## CONSOLIDATED BALANCE SHEETS
(in thousands)

| | September 30, 1998 (UNAUDITED) | December 31, 1997 |
|---|---|---|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | $ 4,939 | $ 5,382 |
| Short-term investments | 138,834 | |
| Receivables less allowances | 257,882 | 187,385 |
| Inventories | 144,821 | 198,053 |
| Other current assets | 5,858 | 6,459 |
| Total current assets | 552,334 | 397,279 |
| Property, Plant, and Equipment | 137,638 | 105,188 |
| Less accumulated depreciation and amortization | (39,576) | (28,221) |
| Total property, plant, and equipment, net | 98,062 | 76,967 |
| Other Assets | | |
| Investments | 229,673 | 185,111 |
| Notes and other receivables | 30,187 | 21,035 |
| Excess of cost over net assets of businesses acquired, net | 77,147 | 26,168 |
| Other | 9,444 | 7,981 |
| Total other assets | 346,451 | 240,295 |
| Total Assets | $996,847 | $714,541 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Current debt obligations | $ 4,815 | $ 3,396 |
| Accounts payable | 130,218 | 74,025 |
| Accrued expenses | 133,869 | 91,857 |
| Total current liabilities | 268,902 | 169,278 |
| Long-Term Debt | 253,494 | 127,089 |
| Deferred Taxes | 10,478 | 20,044 |
| Minority Interest and Other | 104,389 | 100,179 |
| Convertible Subordinated Notes | 71,345 | 90,881 |
| Shareholders' Equity | | |
| Common stock | 3,280 | 3,280 |
| Additional paid-in capital | 61,608 | 49,952 |
| Retained earnings | 221,799 | 151,471 |
| Treasury stock, at cost | (13,446) | (13,339) |
| Net unrealized appreciation on investments | 14,998 | 15,706 |
| Total shareholders' equity | 288,239 | 207,070 |
| Total Liabilities and Shareholders' Equity | $996,847 | $714,541 |

See notes to consolidated financial statements.

**SAFEGUARD SCIENTIFICS, INC.**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
(in thousands except per share data)

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|---|---|---|---|
| | 1998 | 1997 | 1998 | 1997 |
| | (UNAUDITED) | | (UNAUDITED) | |
| Revenues | | | | |
| Net Sales | | | | |
| Product | $535,850 | $439,528 | $1,449,220 | $1,263,196 |
| Services | 73,203 | 65,784 | 204,265 | 192,398 |
| Total net sales | 609,053 | 505,312 | 1,653,485 | 1,455,594 |
| Securities and other gains, net | 100,929 | 6,683 | 117,495 | 20,722 |
| Other income | 3,463 | 3,206 | 10,825 | 8,746 |
| Total revenues | 713,445 | 515,201 | 1,781,805 | 1,485,062 |
| Costs and Expenses | | | | |
| Cost of sales-product | 482,128 | 393,160 | 1,295,217 | 1,128,157 |
| Cost of sales-services | 48,269 | 40,708 | 135,293 | 120,382 |
| Selling and service | 46,570 | 33,637 | 127,336 | 99,316 |
| General and administrative | 24,763 | 22,174 | 69,021 | 64,859 |
| Depreciation and amortization | 5,968 | 4,205 | 15,879 | 13,760 |
| Interest and financing | 8,651 | 5,998 | 21,145 | 16,321 |
| (Income) loss from equity investments, net | 4,714 | (491) | 467 | (909) |
| Total costs and expenses | 621,063 | 499,391 | 1,664,358 | 1,441,886 |
| Earnings Before Minority Interest and Taxes on Income | 92,382 | 15,810 | 117,447 | 43,176 |
| Minority interest | (818) | (7,035) | (7,407) | (17,519) |
| Earnings Before Taxes On Income | 91,564 | 8,775 | 110,040 | 25,657 |
| Provision for taxes on income | 32,322 | 3,510 | 39,712 | 10,264 |
| Net Earnings | $ 59,242 | $ 5,265 | $ 70,328 | $ 15,393 |
| Earnings Per Share | | | | |
| Basic | $ 1.85 | $ .17 | $ 2.20 | $ .49 |
| Diluted | $ 1.71 | $ .16 | $ 2.04 | $ .47 |
| Average Common Shares Outstanding | | | | |
| Basic | 32,010 | 31,291 | 31,920 | 31,247 |
| Diluted | 34,983 | 31,971 | 35,112 | 32,007 |

See notes to consolidated financial statements.

**SAFEGUARD SCIENTIFICS, INC.**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
(in thousands)

| | Nine Months Ended September 30 | |
|---|---|---|
| | 1998 | 1997 |
| | (UNAUDITED) | |
| Operating Activities | | |
| Net earnings | $ 70,328 | $ 15,393 |
| Adjustments to reconcile net earnings to cash provided (used) by operating activities | | |
| Depreciation and amortization | 15,879 | 13,760 |
| Deferred income taxes | (9,202) | 2,767 |
| (Income) loss from equity investments, net | 467 | (909) |
| Securities and other gains, net | (117,495) | (20,722) |
| Minority interest, net | 4,444 | 10,511 |
| Cash provided (used) by changes in working capital items | | |
| Receivables | (153) | 149,104 |
| Inventories | 62,799 | 63,711 |
| Accounts payable, accrued expenses, and other | 18,304 | (128,084) |
| Cash provided by operating activities | 45,371 | 105,531 |
| Proceeds from securities and other gains, net | 36,811 | 50,347 |
| Cash provided by operating activities and securities and other gains, net | 82,182 | 155,878 |
| Other Investing Activities | | |
| Investments and notes acquired, net | (112,565) | (50,414) |
| Capital expenditures | (14,902) | (26,019) |
| Business acquisitions, net of cash acquired | (49,288) | |
| Other, net | (1,478) | 1,036 |
| Cash used by other investing activities | (178,233) | (75,397) |
| Financing Activities | | |
| Net borrowings (repayments) on revolving credit facilities | 100,483 | (86,191) |
| Net borrowings on term debt | 1,868 | 685 |
| Repurchase of Company common stock | (9,867) | (6,152) |
| Issuance of Company common stock | 2,386 | 1,498 |
| Issuance of subsidiary common stock | 738 | 2,176 |
| Cash provided (used) by financing activities | 95,608 | (87,984) |
| Decrease in Cash and Cash Equivalents | (443) | (7,503) |
| Cash and Cash Equivalents - beginning of year | 5,382 | 12,881 |
| Cash and Cash Equivalents - End of Period | $ 4,939 | $ 5,378 |

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements September 30, 1998

1. General

The accompanying unaudited interim consolidated financial statements were prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The Summary of Accounting Policies and Notes to Consolidated Financial Statements included in the 1997 Form 10-K should be read in conjunction with the accompanying statements. These statements include all adjustments (consisting only of normal recurring adjustments) which the Company believes are necessary for a fair presentation of the statements. The interim operating results are not necessarily indicative of the results for a full year.

2. Comprehensive Income

The Company adopted Statement of Financial Accounting Standard No. 130, "Reporting Comprehensive Income" (SFAS 130), which was effective for fiscal years beginning after December 15, 1997. SFAS 130 establishes standards for reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income is the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Other than net earnings, the Company's source of comprehensive income is from net unrealized appreciation on its non-current investments which is disclosed separately in the Shareholders' Equity section of the Consolidated Balance Sheets. Total comprehensive income (the sum of net earnings and the change in unrealized appreciation on investments) was $45.2 million and $9.0 million for the three months ended September 30, 1998 and 1997, respectively, and $69.6 million and $24.3 million for the nine months ended September 30, 1998 and 1997, respectively.

3. Reclassifications

Certain amounts in the 1997 financial statements have been reclassified to conform with the 1998 presentation.

4. Sale of Coherent

On August 3, 1998, Coherent Communications Systems Corporation merged with Tellabs, Inc. in a pooling of interests. Prior to the merger, the Company owned 31% of Coherent and accounted for its investment on the equity method. The Company received approximately 3.5 million shares of Tellabs in exchange for all of its Coherent shares and recorded a book gain of $245.3 million in the third quarter of 1998.

The Company owns less than 5% of Tellabs and accounts for its investment in Tellabs on the cost method. The Company's investment in Tellabs is classified as a trading security (classified as Short-term Investments on the Consolidated Balance Sheet) and is recorded at market value based on quoted market prices. Unrealized holding gains and losses are reflected in net earnings. Net unrealized holding losses on trading securities included in net earnings for the three and nine months ended September 30, 1998 was $123.8 million based on the market price of Tellabs common stock of $39.81 at September 30, 1998. The closing price of Tellabs on November 13, 1998 was $56.63. The Company has sold approximately 1.1 million shares of Tellabs in the fourth quarter through November 13, 1998. The Company will mark-to-market the value of its remaining Tellabs holdings (approximately 2.4 million shares at November 13, 1998) at the end of each quarter. Fluctuations in the price of Tellabs stock may have a significant impact on the Company's future reported earnings.

5. Investments

The following summarizes the Company's non-current investments (in thousands), which excludes trading securities (Tellabs) classified as Short-Term Investments (see Note 4). Investments are classified according to the applicable accounting method at September 30, 1998. Market value reflects the price of publicly-traded securities at the close of business at the respective date. Unrealized appreciation reflects the net excess of market value over carrying value of publicly-traded securities classified as available-for-sale.

| | September 30, 1998 | | December 31, 1997 | | |
|---|---|---|---|---|---|
| | Carrying Value | Market Value | Carrying Value | Market Value | |
| | (UNAUDITED) | | | | |
| Equity Investees | | | | | |
| Cambridge | $ 31,735 | $191,829 | $ 24,679 | $371,394 | |
| ChromaVision | 11,737 | 24,346 | 4,689 | 30,044 | |
| Coherent | | | 14,799 | 135,008 | (a) |
| OAO | 16,306 | 23,232 | 13,887 | 43,716 | |
| Sanchez | 10,050 | 72,314 | 7,196 | 89,068 | |
| USDATA | 7,002 | 9,209 | 7,194 | 13,325 | |
| Non-public companies | 28,281 | | 18,453 | | |
| | 105,111 | | 90,897 | | |
| Diamond | 1,526 | 15,752 | 1,526 | 14,717 | |
| DocuCorp | 3,195 | 4,654 | 7,718 | | |
| Integrated Systems Consulting Group | 1,891 | 7,502 | 1,891 | 7,785 | |
| Other public companies | 13,351 | 14,780 | 15,393 | 20,104 | |
| Unrealized appreciation | 22,725 | | 23,796 | | |
| Non-public companies | 81,874 | | 43,890 | | |
| | $229,673 | | $185,111 | | |

(a) Coherent merged with Tellabs in August 1998. See Note 4.

The following sales information for unconsolidated investees at September 30, 1998 has been compiled from the unaudited financial statements of the respective investees and reflects certain historical adjustments (in thousands):

| | Three Months Ended September 30, 1998 | Three Months Ended September 30, 1997 | Nine Months Ended September 30, 1998 | Nine Months Ended September 30, 1997 |
|---|---|---|---|---|
| | (UNAUDITED) | | (UNAUDITED) | |
| Public companies | $252,270 | $202,478 | $754,243 | $552,442 |
| Non-public companies: | | | | |
| Intellisource | 35,740 | 29,760 | 97,713 | 83,943 |
| Kanbay | 10,056 | 5,129 | 25,882 | 13,348 |
| Multigen | 3,436 | 5,080 | 12,443 | 13,759 |
| Pac-West Telecomm | 9,500 | 7,998 | 29,432 | 19,411 |
| Quest One | 3,162 | 904 | 6,872 | 1,478 |
| US Interactive | 4,554 | 3,229 | 13,179 | 9,048 |
| Other | 13,196 | 12,814 | 39,000 | 32,239 |
| | 79,644 | 64,914 | 224,521 | 173,226 |
| Total Investee Sales | $331,914 | $267,392 | $978,764 | $725,668 |

6. Debt

In April 1998, the Company increased the availability under its bank revolving credit facility to $200 million from $150 million. Of the $200 million, $150 million matures in May 2002 and is secured by certain equity securities the Company holds of its publicly-traded partnership companies, including CompuCom (the "Pledged Securities"). The remaining $50 million is unsecured and matures in April 1999, with availability limited to the lesser of $50 million or 10% of the value of the Pledged Securities. The Company intends to renew the $50 million bank revolving credit facility in 1999. There was $108 million outstanding under the total facility at September 30, 1998. Long-term debt consisted of (in thousands):

| | September 30, 1998 | December 31, 1997 |
|---|---|---|
| | (UNAUDITED) | |
| Parent Company and Other Recourse Debt | | |
| Revolving credit facilities | $127,261 | $ 22,200 |
| Other | 16,044 | 7,822 |
| | 143,305 | 30,022 |
| Subsidiary Debt (Non-Recourse to Parent) | | |
| CompuCom | 115,004 | 100,425 |
| Other | | 38 |
| | 115,004 | 100,463 |
| Total debt | 258,309 | 130,485 |
| Current debt obligations | (4,815) | (3,396) |
| Long-term debt | $253,494 | $127,089 |

7. Earnings Per Share

The calculations of Earnings Per Share (EPS) were (in thousands except per share amounts):

| | Three Months Ended September 30, 1998 | Three Months Ended September 30, 1997 | Nine Months Ended September 30, 1998 | Nine Months Ended September 30, 1997 |
|---|---|---|---|---|
| | (UNAUDITED) | | (UNAUDITED) | |
| Basic EPS | | | | |
| Net earnings | $59,242 | $ 5,265 | $70,328 | $15,393 |
| Average common shares outstanding | 32,010 | 31,291 | 31,920 | 31,247 |
| Basic EPS | $ 1.85 | $ .17 | $ 2.20 | $ .49 |
| Diluted EPS | | | | |
| Net earnings | $59,242 | $ 5,265 | $70,328 | $15,393 |
| Effect of: Public investees (a) | (220) | (39) | (814) | (218) |
| Dilutive securities (b) | 725 | | 2,269 | |
| | $59,747 | $ 5,226 | $71,783 | $15,175 |
| Average common shares outstanding | 32,010 | 31,291 | 31,920 | 31,247 |
| Effect of: Dilutive options | 512 | 680 | 643 | 760 |
| Dilutive securities (b) | 2,461 | | 2,549 | |
| Average number of common shares assuming dilution | 34,983 | 31,971 | 35,112 | 32,007 |
| Diluted EPS | $ 1.71 | $ .16 | $ 2.04 | $ .47 |

(a) Represents the dilutive effect of public investee common stock equivalents and convertible securities.

(b) Represents the dilutive effect of the Company's 6% convertible subordinated notes for the three and nine months ended September 30, 1998. The convertible subordinated notes were anti-dilutive in 1997 and therefore they do not impact the calculation of diluted EPS in 1997.

8. Parent Company Financial Information

Condensed Financial Information is provided to reflect the results of operations and financial position of the "Parent Company", or the Company without the effect of consolidating its less than wholly-owned subsidiaries.

The following summarizes the Parent Company Balance Sheets of Safeguard Scientifics, Inc. and its wholly-owned subsidiaries (in thousands). These Parent Company Balance Sheets differ from the Consolidated Balance Sheets due to the exclusion of the assets and liabilities of the Company's less than wholly-owned subsidiaries, primarily CompuCom and Tangram, with the carrying value of these companies included in "Investments".

| | September 30, 1998 | December 31, 1997 |
|---|---|---|
| | (UNAUDITED) | |
| ASSETS | | |
| Short-term investments | $138,834 | |
| Other current assets | 7,198 | $ 11,710 |
| Investments | 359,090 | 310,877 |
| Other | 60,381 | 37,567 |
| Total assets | $565,503 | $360,154 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities | $ 58,114 | $ 18,525 |
| Long-term debt | 142,703 | 29,689 |
| Other liabilities | 5,102 | 13,989 |
| Convertible subordinated notes | 71,345 | 90,881 |
| Shareholders' equity | 288,239 | 207,070 |
| Total liabilities & shareholders' equity | $565,503 | $360,154 |

The following summarizes the Parent Company's investments in less than wholly-owned subsidiaries (in thousands). Market value reflects the price of publicly-traded securities at the close of business at the respective date.

| | September 30, 1998 | | December 31, 1997 | |
|---|---|---|---|---|
| | Carrying Value | Market Value | Carrying Value | Market Value |
| | (UNAUDITED) | | | |
| CompuCom | $126,710 | $109,521 | $122,613 | $211,504 |
| Tangram | 2,707 | 36,571 | 3,153 | 68,570 |
| Cambridge | 31,735 | 191,829 | 24,679 | 371,394 |
| Coherent | | | 14,799 | 135,008 |
| Other public | 87,783 | 171,789 | 83,290 | 218,759 |
| Other | 110,155 | | 62,343 | |
| | $359,090 | | $310,877 | |

## Parent Company Financial Information (continued)

The following summarizes the Parent Company Statements of Operations of Safeguard Scientifics, Inc. and its wholly-owned subsidiaries (in thousands). These Parent Company Statements of Operations differ from the Consolidated Statements of Operations by excluding the revenues and related costs and expenses of the Company's less than wholly-owned subsidiaries, primarily CompuCom and Tangram, with the Company's share of the earnings or losses of these companies reflected in the caption "Equity (income) loss, net ". 1997 included net sales of $16.0 million and cost of sales and operating expenses of $14.6 million, for the nine months ended September 30, 1997, related to Pioneer which was sold in mid-1997.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 1998 | 1997 | 1998 | 1997 |
| | (UNAUDITED) | | (UNAUDITED) | |
| Revenues | | | | |
| Net sales | | | | $15,982 |
| Securities and other gains, net | $100,929 | $5,830 | $117,495 | 19,869 |
| Other income | 3,754 | 3,489 | 11,719 | 9,745 |
| Total revenues | 104,683 | 9,319 | 129,214 | 45,596 |
| Costs and Expenses | | | | |
| Cost of sales and operating expenses | 9,441 | 8,068 | 26,367 | 36,614 |
| Equity (income) loss, net | 4,111 | (4,295) | (3,871) | (8,962) |
| Total costs and expenses | 13,552 | 3,773 | 22,496 | 27,652 |
| Earnings Before Taxes On Income | 91,131 | 5,546 | 106,718 | 17,944 |
| Provision for taxes on income | 31,889 | 281 | 36,390 | 2,551 |
| Net Earnings | $ 59,242 | $5,265 | $ 70,328 | $15,393 |

9. Business Combinations

During the nine months ended September 30, 1998, CompuCom completed three business combinations for approximately $49 million in cash. These business combinations were accounted for as purchases and accordingly the consolidated financial statements reflect the operations of the acquired entities since the respective acquisition dates. CompuCom has not completed the allocation of the purchase price for two of these acquisitions; accordingly, the amount of goodwill recorded could be adjusted once the allocation is finalized.

The following pro forma financial information (in thousands except per share amounts) presents the combined results of operations of the Company as if the acquisitions had occurred as of January 1, 1998, after giving effect to certain adjustments, including amortization of goodwill, increased interest expense on debt related to the acquisitions, and related income tax effects.

| | Pro Forma Nine Months Ended September 30, 1998 |
|---|---|
| Total Revenues | $1,972,275 |
| Net Earnings | $67,470 |
| Diluted earnings per share | $1.96 |

In management's opinion, 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 periods presented and is not intended to be a projection of future results. Pro forma adjustments that give effect to actions taken by CompuCom's management or other efficiencies expected to be realized as a result of the transactions, including termination of employees and closure of facilities, are not reflected in the above pro forma results of operations.

10. Subsequent Event

On November 4, 1998, CompuCom announced a significant restructuring of its operations for which CompuCom expects to record a one-time charge in the fourth quarter of 1998. The restructuring is designed to reduce CompuCom's product cost structure by closing branch facilities and reducing CompuCom's workforce by approximately 10%. Although the restructuring plan has not been finalized, CompuCom expects the charge to be approximately $20 to $25 million, the effect of which will be approximately $10 million to $12.5 million to the Company's net earnings, after recording Minority Interest.

**General**

The Company's business strategy is the development of primarily information technology-oriented, entrepreneurially-driven partnership companies. The Company provides to its partnership companies and associated venture funds active strategic management, operating guidance, acquisition and disposition assistance, board and management recruitment, and innovative financing. The Company's primary goal is to achieve superior returns for its shareholders by bringing companies which it believes are ready for public ownership to its shareholders through the rights offering process. This process gives shareholders the opportunity to acquire direct ownership in selected partnership companies at their initial public offering date.

If the Company's ownership in any of the partnership companies changes significantly, the Company's consolidated revenues and related costs and expenses may fluctuate primarily due to the applicable accounting method used for recognizing its participation in the operating results of that company.

The revenues and related costs and expenses of a partnership company are included in the Company's consolidated operating results if the Company owns more than 50% of the outstanding voting securities of the partnership company. Participation of shareholders other than the Company in the earnings or losses of a more than 50% owned partnership company is reflected in the caption "Minority interest" in the Consolidated Statements of Operations. Minority interest adjusts consolidated earnings to reflect only the Company's share of the earnings or losses of the partnership company. CompuCom Systems, Inc. and Tangram Enterprise Solutions, Inc. are consolidated in 1998 and 1997. Premier Solutions Ltd. and Pioneer Metal Finishing, which were sold in mid-1997, also were included in the Company's consolidated operating results for the first six months of 1997.

Investments in companies in which the Company owns 50% or less of the outstanding voting securities, in which significant influence is exercised, are accounted for on the equity method of accounting. Significant influence is presumed at a 20% ownership level; however, the Company applies the equity method for certain companies in which it owns less than 20% because it exerts significant influence through representation on those companies' Boards of Directors and other means. On the equity method of accounting, a partnership company's revenues and related costs and expenses are not included in the Company's consolidated operating results; however, the Company's share of the earnings or losses of the partnership company is reflected in the caption "(Income) loss from equity investments, net" in the Consolidated Statements of Operations.

The net effect of a partnership company's results of operations on the Company's net earnings is the same under either consolidation accounting or the equity method of accounting, as only the Company's share of the earnings or losses of a partnership company is included in the Company's net earnings in the Consolidated Statements of Operations.

Investments not consolidated or accounted for on the equity method are accounted for on the cost method of accounting under which the Company's share of the earnings or losses of such companies is not included in the Company's Consolidated Statements of Operations. However, the effect of the change in market value of cost method investments classified as trading securities (Tellabs) is reflected in the Company's results of operations each reporting period.

As mentioned in Operations Overview, the Company's consolidated revenues and related costs and expenses are significantly influenced by CompuCom's results of operations. At September 30, 1998, the Company owns approximately 51% of CompuCom's outstanding common stock and owns preferred stock which gives it 60% of the vote for CompuCom's directors.

CompuCom competes in the computer reseller industry which has been undergoing significant transformation and consolidation. Several of CompuCom's competitors have been growing through acquisitions and others have been acquired. In addition, companies previously engaged in the retail channel and some of CompuCom's suppliers have begun to enter the corporate reseller market, heightening the competition.

As a result, while growing internally, CompuCom is also looking to strengthen its market share through acquisitions, including three acquisitions which were completed in 1998. If CompuCom were to use its stock for acquisitions or if some other dilutive event were to occur, the Company's voting interest in CompuCom could decrease below 50%. Under current generally accepted accounting principles, the Company would cease consolidating CompuCom's results and instead would account for its investment in CompuCom on the equity method provided the Company maintained the ability to exercise significant influence over CompuCom's ordinary course of business. The Company's share of CompuCom's earnings, on the equity method versus consolidation, would differ only to the extent that the Company's ownership of CompuCom changed. However, the presentation of the Consolidated Statements of Operations and Balance Sheets would change dramatically.

**Note 8 to the Company's Consolidated Financial Statements summarizes**
the Parent Company Statements of Operations and Balance Sheets of the Company for the same periods presented in the Consolidated Financial Statements. These statements differ from the Consolidated Financial Statements by excluding the revenues, costs, expenses, assets, and liabilities of the Company's less than wholly-owned subsidiaries (primarily CompuCom and Tangram) and instead treating these companies as if they were accounted for on the equity method. The Company's share of the results of operations of less than wholly-owned subsidiaries is included in "Equity (income) loss, net" and the carrying value of these companies is included in "Investments" in the Parent Company Statements of Operations and Balance Sheets, respectively.

Although the Parent Company Statements of Operations and Balance Sheets presented in Note 8 are accurate relative to the Company's historical Consolidated Financial Statements, they are not necessarily indicative of future Parent Company Statements of Operations and Balance Sheets.

**Restructuring**

On November 4, 1998, CompuCom announced a restructuring plan designed to reduce CompuCom's product cost structure by approximately 1.25% to 1.5% of sales by closing branch facilities and reducing CompuCom's workforce by approximately 10%. CompuCom intends to maintain local presence in all current markets through the use of remote communications. The restructuring charge will primarily consist of costs associated with closing branch facilities and disposing of related fixed assets as well as employee severance and benefits related to the reduction in workforce. The restructuring plan has not been finalized and therefore CompuCom has not yet calculated the final amount of the restructuring charge. However, CompuCom expects the charge to be approximately $20 million to $25 million, the effect of which will be approximately $10 million to $12.5 million to the Company's net earnings, after recording Minority Interest. The Company expects to meet its targeted earnings per share for the fourth quarter of 1998 prior to recognizing its share of Compucom's restructuring charge and prior to any unrealized gain or loss on the Company's remaining Tellabs holdings. The Company's unrealized gain on its current Tellabs holdings would fully offset its share of the restructuring charge if Tellabs closes in the $44-$45 range at December 31, 1998.

As a result of its recently announced restructuring plan, CompuCom's management expects to realize reductions in operation expenses, primarily in selling and general and administrative expenses. The reductions have not yet been completely finalized and are not expected to be fully realized until the first quarter of 1999.

**Operations Overview**

Net sales by industry segment were (in thousands):

| | Three Months Ended September 30, 1998 | Three Months Ended September 30, 1997 | Nine Months Ended September 30, 1998 | Nine Months Ended September 30, 1997 |
|---|---|---|---|---|
| | (UNAUDITED) | | (UNAUDITED) | |
| Information Technology | | | | |
| Microcomputer Systems and Services | $603,330 | $501,504 | $1,638,639 | $1,424,613 |
| Information Solutions | 5,723 | 3,808 | 14,846 | 14,999 |
| | 609,053 | 505,312 | 1,653,485 | 1,439,612 |
| Other | | | | 15,982 |
| Total Net Sales | $609,053 | $505,312 | $1,653,485 | $1,455,594 |

Net sales increased for the three and nine months ended September 30, 1998 compared to the same periods in 1997 as CompuCom (Microcomputer Systems and Services) experienced sales increases of 20% and 15%, respectively. The sales increases at CompuCom were due primarily to increased product sales resulting from the acquisitions of Computer Integration Corporation and Dataflex Corporation during the second quarter of 1998. These acquisitions contributed $98 million and $149 million of product sales for the three and nine months ended September 30, 1998, respectively. CompuCom sold more desktop, laptop, and server units in the three and nine months ended September 30, 1998 compared to the same periods in 1997. However, a decline in the average sales prices of these units lessened the impact of this unit growth on revenue. Although the trend of declining average sales prices has slowed in 1998 compared to 1997, CompuCom expects to be continually impacted by this trend in the short term, as CompuCom must sell more units to generate the same amount of product sales. Services sales increased 12% for the three months ended September 30, 1998 compared to the same period in 1997 due to increases in configuration and field engineering, both of which have benefited from the increase in product unit sales. CompuCom represented 99% of the Company's total consolidated net sales in the third quarter of 1998 and 1997. As a result of the relative significance of CompuCom in the consolidated results, fluctuations in the financial results of other business units have tended to have a minimal impact.

The Company's net earnings increased primarily from higher securities and other gains resulting from the gain on the merger of Coherent and Tellabs, partially offset by unrealized losses resulting from the decline in the market price of Tellabs subsequent to the merger. Additionally, net earnings were positively impacted by increased earnings at Tangram, offset by decreased earnings at CompuCom, increased general corporate expense to support the increased activity at partnership companies, and decreased equity income. CompuCom's net earnings decreased due to increased selling expenses, continued investments in its service business through the hiring and training of additional engineer and support personnel, lower services margins and, for the three months ended September 30, 1998, lower product margins. Future profitability at CompuCom will depend on its ability to effectively manage inventory levels in response to changes in its major suppliers price protection and return programs, its ability to effectively manage the utilization of service personnel, its control of operating expenses, demand for product, competition, manufacturer product availability, effective utilization of vendor programs, its ability to successfully manage the implementation and operation of the channel assembly programs of its major suppliers, its ability to adequately integrate recent acquisitions, and its ability to implement the recently announced virtual office strategy.

The following summarizes significant pre-tax securities and other gains (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 1998 | 1997 | 1998 | 1997 |
| | (UNAUDITED) | | (UNAUDITED) | |
| Coherent/Tellabs, net | $121.5 | | $121.5 | |
| Cambridge | 1.6 | $6.1 | 17.5 | $18.1 |
| ChromaVision | | 3.9 | | 3.9 |
| Premier | | | | 6.3 |
| Venture Funds | 3.3 | 1.5 | 9.5 | 2.0 |
| Diamond | | 1.1 | | 5.4 |
| Sybase | | | (2.2) | (3.0) |
| Other | (25.5) | (5.9) | (28.8) | (12.0) |
| | $100.9 | $6.7 | $117.5 | $20.7 |

The Coherent/Tellabs net gain includes the $245.3 million gain on the merger of Coherent and Tellabs, partially offset by unrealized losses resulting from the decline in the market price of Tellabs subsequent to the merger of $123.8 million through September 30, 1998. Securities and other gains in 1998 also include the open market sales of a portion of the Company's interest in Cambridge Technology Partners, and distributions from the Company's associated Venture Funds. Partially offsetting these gains was a write-down of the Company's holdings in Sybase due to the other than temporary decline in the market price of that stock, charges incurred in the disposition of investments and provisions for other investments and notes. Securities and other gains in 1997 included the open market sales of a portion of the Company's interest in Cambridge, the sale of shares in the Diamond and ChromaVision rights offerings, the sale of all of the assets of Premier Solutions Ltd., and distributions from the Company's associated Venture Funds. Partially offsetting these gains was a write-down of the Company's holdings in Sybase due to the other than temporary decline in the market price of that stock, charges incurred in the disposition of investments, and provisions for other investments and notes. Securities and other gains of varying magnitude have been realized in recent years; prior gains are not necessarily indicative of gains which may be realized in the future.

Income or loss from equity investments fluctuates with the Company's ownership percentage and the operating results of investees accounted for on the equity method. In the third quarter of 1998, the Company discontinued accounting for its investment in Coherent on the equity method of accounting as a result of the Coherent/Tellabs merger. In addition, the Company recorded its share of merger-related charges at certain partnership companies. Primarily as a result of these transactions, equity income decreased for the three months ended September 30, 1998. For the nine months ended September 30, 1998, equity income decreased as a result of the above transactions and increased losses at certain partnership companies, partially offset by the continued strong overall performance at Cambridge and Sanchez. The Company's public investments accounted for on the equity method in the third quarter of 1998 include Cambridge, ChromaVision Medical Systems, OAO Technology Solutions, Sanchez Computer Associates and USDATA Corporation.

Cambridge reported increased sales and earnings of 31% and 47%, respectively. The lower sales growth reflects downward pressure in its North American Rapid Application Deployment (RAD) business. During the third quarter, Cambridge completed the acquisition of Excell Data Corporation, a systems integrator of Microsoft-centric solutions, which enhances Cambridge's service offerings by providing additional resources for its RAD business. Safeguard owns approximately 15% of Cambridge's common stock at September 30, 1998.

ChromaVision entered into an agreement with DAKO Corp., an international diagnostics, reagent and systems manufacturing firm. Under the agreement, the two firms will co-market ChromaVision's Automated Cellular Imaging System (ACIS-TM-) in combination with DAKO's HercepTest-Registered Trademark- kit in the United States as an integrated system for the guidance of breast cancer therapy. Safeguard owns approximately 26% of ChromaVision's common stock at September 30, 1998

OAO Technology Solutions completed the acquisition of a $60 million IT staffing augmentation services company in July 1998. OAO reported an operating profit of $.02 per share for the third quarter before certain adjustments, including one-time write-offs and restructuring charges, which resulted in a net loss of $.12 per share. Safeguard owns approximately 33% of OAO's common stock at September 30, 1998.

Sanchez reported 43% and 70% increases in sales and earnings, respectively, for the third quarter. Sanchez also announced in the quarter that it signed a global partnership with IBM Corporation for the sales, marketing and implementation of Sanchez's software products and a licensing agreement with Citicorp, bringing to three the number of top ten global financial institutions who have licensed Sanchez's products. Safeguard owns approximately 27% of Sanchez's common stock at September 30, 1998.

For the third quarter of 1998, USDATA reported a loss from continuing operations (before taxes) of $1.8 million, an improvement over the $2.1 million loss from continuing operations (before taxes) for the third quarter of 1997. USDATA reported a 17% increase in software unit shipments in the third quarter of 1998 over the same period in 1997. In July 1998, USDATA announced the sale of its system integration and hardware servicing business effective July 1, 1998. USDATA's third quarter revenues and operating expenses reflect its ongoing software business. Safeguard owns approximately 26% of USDATA's common stock at September 30, 1998.

**Costs and Expenses**

The Company's overall gross margin was 12.9% and 13.5% in the three and nine months ended September 30, 1998 compared to 14.1% and 14.2% for the comparable periods of 1997. The decreases are primarily attributable to reduced service gross margins at CompuCom and, for the three months ended September 30, 1998, reduced product margins at CompuCom. CompuCom's product gross margin for the third quarter of 1998 was 9.3% compared to 10.1% for the same period in 1997. CompuCom attributes this to a decline in billed margins due to intense competition from other corporate resellers and direct marketers. CompuCom's product gross margin for the nine months ended September 30, 1998 and 1997 was 10.0%. For the nine month period, the decline in billed margins was offset by an increase in the amount of manufacturer-sponsored incentives when compared to the prior year. CompuCom's services gross margin was 32.3% and 31.9% in the three and nine months ended September 30, 1998 compared to 36.3% and 36.5% for the comparable periods of 1997. The decrease was primarily caused by lower billing per engineer for CompuCom's service personnel, particularly in the systems engineering group. CompuCom participates in certain manufacturer-sponsored programs designed to increase sales of specific products. These programs, excluding volume incentive programs and specific product rebates offered by certain manufacturers, are not material when compared to CompuCom's overall financial results.

Selling and service increased in absolute dollars and as a percentage of sales for the three and nine months ended September 30, 1998 compared to 1997 primarily due to increased expenses at CompuCom. The increases at CompuCom were primarily due to the hiring of additional sales representatives during the first quarter of 1998, higher commission expense, an increase in the sales force as a result of the CIC and Dataflex acquisitions, and increased spending on training the Company's engineer force.

General and administrative expense increased in absolute dollars for the three and nine months ended September 30, 1998 compared to 1997 primarily due to increased expenses at CompuCom and increased corporate expenses incurred to support the growing activities of the partnership companies. The increase for the nine months ended September 30, 1998 was partially offset by the elimination of expenses resulting from the sale of Premier and Pioneer in mid-1997. The increases at CompuCom were primarily due to the costs associated with the integration of CIC and Dataflex as well as CompuCom's ongoing campus recruitment program. The campus recruits complete training and certification programs before being added to CompuCom's billable workforce. CompuCom's general and administrative expenses are reported net of reimbursements by certain manufacturers for specific training, promotional and marketing programs. These reimbursements offset the expenses incurred by CompuCom.

Depreciation and amortization increased for the three and nine months ended September 30, 1998 compared to 1997 primarily due to increased depreciation at CompuCom. The increase for the nine months ended September 30, 1998 was partially offset by the elimination of depreciation and amortization resulting from the sale of Premier and Pioneer in mid-1997. The increase at CompuCom is associated with upgrading its hardware and software at headquarters and branch locations, increased furniture and fixtures to support headcount additions, depreciation related to CompuCom's headquarters and operations campus which was placed in service during the third quarter of 1997, and an increase in amortization expense as a result of acquisitions completed during the first half of 1998.

Interest and financing expense increased for the three and nine months ended September 30, 1998 compared to the same periods in 1997 primarily as a result of increased borrowings at CompuCom to fund the acquisitions of CIC and Dataflex, and increased borrowings by the Company primarily to fund investments in new or existing partnership companies, partially offset by the elimination of interest due to the conversion of $18.5 million of the Company's Convertible Subordinated Notes into the Company's Common Stock in February 1998.

For the three and nine months ended September 30, 1998, the effective tax rate was 35.3% and 36.1%, respectively, compared to 40.0% for the three and nine months ended September 30, 1997. The effective rate decreased due to the realization of previously unrecorded tax benefits attributable to the difference between the book basis and tax basis of certain of the Company's investments, as well as the application of lower tax rates against realized investment gains.

**Liquidity and Capital Resources**

In February 1996, the Company issued $115 million of 6% Convertible Subordinated Notes (the "Notes") due February 1, 2006. The Notes are convertible into the Company's Common Stock at $28.985 per share. Through September 1998, approximately $43.7 million of Notes were converted into 1,506,119 shares of the Company's Common Stock.

In April 1998, the Company increased the availability under its bank revolving credit facility to $200 million from $150 million. Of the $200 million, $150 million matures in May 2002 and is secured by certain equity securities the Company holds of its publicly-traded partnership companies, including CompuCom (the "Pledged Securities"). The value of these Pledged Securities significantly exceeds the total availability under the bank revolving credit facility. The remaining $50 million is unsecured, matures in April 1999, with availability limited to the lesser of $50 million or 10% of the value of the Pledged Securities. The Company intends to renew the $50 million bank revolving credit facility in 1999. There was $108 million outstanding under the total facility at September 30, 1998.

The Company has revolving credit facilities with certain partnership companies whereby the Company may borrow up to $20 million from these partnership companies on a revolving basis at a rate that varies with the Company's effective borrowing rate. At September 30, 1998, $19.3 million was outstanding under these agreements.

Availability under the Company's revolving credit facilities, proceeds from the sales from time to time of selected publicly-traded securities, and other internal sources of cash flow should be sufficient to fund the Company's cash requirements for the next twelve months, including investments in new or existing partnership companies, general corporate requirements, and the repurchase of the Company's Common Stock from time to time in the open market. In connection with certain investments, the Company is contingently obligated for approximately $30 million of guarantee commitments. In addition, it has committed capital of $77 million to various investments, venture funds and private equity partnerships, to be funded over the next several years.

CompuCom maintains separate, independent financing arrangements, which are non-recourse to the Company and are secured by certain assets of CompuCom. During recent years, CompuCom has utilized operating earnings, bank financing arrangements, long-term subordinated notes, and internally generated funds to fund its cash requirements. CompuCom's financing arrangements consist of a $165 million working capital facility (increased from $125 million in June 1998), a $175 million revolving Securitization Facility, and a $25 million real estate loan (collectively, the "credit agreements"). At September 30, 1998, approximately $109 million was outstanding under the working capital facility and the real estate loan, and the Securitization Facility was fully utilized. The credit agreements mature in November 2002, except for the real estate loan which is due in quarterly installments beginning April 1999. Compucom is currently evaluating other permanent financing options for the real estate loan.

During the nine months ended September 30, 1998, CompuCom completed three business combinations for approximately $49 million in cash. These business combinations were accounted for as purchases.

Working capital increased to $283.4 million at September 30, 1998 compared to $228.0 million at December 31, 1997. The increase was primarily due to the classification of the Company's Tellabs holdings as a trading security following the Coherent/Tellabs merger in August 1998, and an increase in accounts receivable at CompuCom as a result of two acquisitions completed in the second quarter of 1998 which resulted in higher sales in the third quarter of 1998 compared to the fourth quarter of 1997. These increases were partially offset by an increase in accounts payable at CompuCom resulting from enhanced cash management, and a decrease in inventory due to ComuCom's effort to reduce its risk associated with changes in its suppliers price protection and return programs and increase its inventory turns.

Cash flow provided by operating activities decreased significantly in 1998 as operating cash flow for the nine months ended September 30, 1997 included the effect of CompuCom's Securitization Facility in which $100 million of accounts receivable were sold with the proceeds used to pay down long-term debt.

The Company has sold approximately 1.1 million shares of Tellabs in the fourth quarter through November 13, 1998, generating proceeds of approximately $53 million.

The Company's operations are not capital intensive, and capital expenditures in any year normally would not be significant in relation to the overall financial position of the Company. Capital asset requirements are generally funded through bank credit facilities, internally generated funds, or other financing sources. There are no material capital asset purchase commitments at September 30, 1998.

**Year 2000**

The Company is currently addressing the Year 2000 issue, which results from the fact that many computer programs were previously written using two digits rather than four to define the applicable year. Programs written in this way may recognize a date ending in "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations causing disruptions of operations. The Company has conducted an assessment of its computer information systems and believes that it will not need to incur any material extraordinary expense to correct its systems which are not Year 2000 compliant on a timely basis. The Company has also surveyed its majority-owned and equity investee partnership companies regarding this issue. The Company's most significant consolidated subsidiary, CompuCom, has completed initial assessment of its computer information systems, and has plans in place to complete remediation and begin testing by the end of 1998. CompuCom currently anticipates that it will spend approximately $1.4 million on Year 2000 compliance, of which $800,000 has been spent through September 30, 1998. The balance of the Company's partnership companies are in varying stages of assessing, remediating, and testing for internal Year 2000 compliance and assessing Year 2000 compliance of their vendors, business partners, and customers. The Company's partnership companies in general do not yet have contingency plans to operate in the event of a Year 2000 problem. The partnership companies generally plan on developing contingency plans in 1999. Most of the partnership companies are in the business of providing software products, information technology consulting, or outsourcing services. Those partnership companies which produce software or products with embedded programming believe that the current version of their products either are Year 2000 compliant or will be revised to be compliant in 1998. Certain partnership companies are continuing to determine the extent to which previously sold software products and services were non-compliant. The total cost and time which will be incurred by the partnership companies on the Year 2000 issue cannot presently be determined. There can be no assurance that all necessary work will be completed in time, or that such costs will not materially adversely impact one or more of such partnership companies. In addition, required spending on the Year 2000 effort will cause customers of most of the Company's partnership companies to reallocate at least part of their information systems budgets. Although several partnership companies have offerings which may be useful in such efforts, such reallocations could materially adversely affect the results of operations of many partnership companies.

**Recently Issued Pronouncements**

In 1997 and 1998, the Financial Accounting Standards Board (FASB) issued pronouncements relating to the presentation and disclosure of information related to segment data and the disclosure of information about pensions and other postretirement benefits, respectively. The Company is required to adopt the provisions of these pronouncements, if applicable, for the year ending December 31, 1998. The adoption of these pronouncements will not have an impact on the Company's financial position and results of operations, but may change the presentation of certain of the Company's notes and data related to the Consolidated Financial Statements.

Certain statements in this Quarterly Report describing the plans, goals, strategies, intentions, forecasts, and expectations of the Company or its partnership companies constitute what are sometimes termed "forward-looking statements." The following important factors could cause actual results to differ materially from those in such forward-looking statements. The information technology industry is highly competitive, characterized by rapid product development cycles, frequent price reductions, and early product obsolescence, and is generally dominated by companies with greater resources than the Company and its partnership companies. Certain of the Company's partnership companies offer complex products or services which have lengthy sales cycles, which makes sales forecasts difficult to make, and can lead to substantial fluctuations in quarterly operating results. Emerging technology companies, including many of the Company's partnership companies, often encounter obstacles and delays in developing products, service offerings, and markets. Such delays and obstacles could affect the Company's ability to complete rights offerings when planned. The Company is dependent on the financial market for information technology companies in general and for initial public offerings of those companies in particular. If the current uncertainty in those markets continues for an extended period of time, the Company's ability to complete rights offerings when planned, and the Company's ability to generate gains from sales of securities, could be materially adversely affected. Clients of the Company's partnership companies could reallocate part or all of their information systems budgets to address the Year 2000 issue, which could materially reduce the demand for the products and services of the Company's partnership companies. The Company's and its partnership companies' business operations could be materially adversely affected if they or their vendors, business partners, or customers do not timely complete any necessary remediation efforts to their own systems and products. There is likely to be an extraordinary amount of litigation regarding the Year 2000 issue over the next several years, and information technology providers may be attractive targets for such litigation. Such litigation could have a material adverse impact on the Company's and its partnership companies' operations and financial conditions.

**Item 5. Other Information**

In July 1998, Who? Vision, a technology company focused on the development of fingerprint identification technologies, filed a registration statement with the Securities and Exchange Commission for an initial public offering of approximately 6,500,000 shares of Who? Vision common stock through a rights offering to Safeguard's shareholders. Due to the uncertainties in the stock market and the poor environment for IPOs, the Company presently intends to delay commencement of additional rights offerings, including the Who? Vision rights offering, until market conditions improve. The Who? Vision rights offering is still in registration, and the decision on a revised target date will be made as market conditions allow.

The merger of Coherent Communications Systems Corporation with Tellabs, Inc. was completed on August 3, 1998. Under the terms of the merger agreement, each share of Coherent Communications common stock held by the Company was exchanged for 0.72 shares of Tellabs common stock.

**Item 6. Exhibits and Reports on Form 8-K**

(a)

| Exhibits Number | Description |
|---|---|
| 10.1 | Amended and Restated Credit Agreement, dated April 17, 1998, among Safeguard Scientifics, Inc., Safeguard Scientifics (Delaware), Inc., Safeguard Delaware, Inc. and PNC Bank, N.A. (exhibits omitted). (1) |
| 10.2 | Amendment No. 1 to Amended and Restated Credit Agreement, dated as of June 26, 1998, among CompuCom Systems, Inc., certain lenders party hereto, and NationsBank of Texas, N.A., as administrative lender (exhibits omitted) (2) |
| 10.3 | Note Agreement dated October 6, 1998, between Safeguard Delaware, Inc. (Lender) and Donald R. Caldwell (Borrower)* |
| 10.4 | Stock Option Grant Agreement between Compucom Systems, Inc. and Thomas C. Lynch, dated as of October 22, 1998* |
| 27 | Financial Data Schedule (electronic filing only) * |

* filed herewith
(1)Incorporated by reference from registrant's form 10-Q for the quarter ended March 31, 1998 dated May 15, 1998 and made a part hereof by such reference
(2) Incorporated by reference from registrant's form 10-Q for the quarter ended June 30, 1998 dated August 14, 1998 and made a part hereof by such reference

(b) No reports on Form 8-K have been filed by the Registrant during the quarter ended September 30, 1998.

## SIGNATURES

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

**SAFEGUARD SCIENTIFICS, INC.**
(Registrant)

| | |
|---|---|
| *Date: November 16, 1998* | */s/ Donald R. Caldwell*<br>----------------------<br>*Donald R. Caldwell*<br>*President and Chief Operating Officer* |
| *Date: November 16, 1998* | */s/ Michael W. Miles*<br>--------------------<br>*Michael W. Miles*<br>*Senior Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)* |

**Exhibit 10.3**

# NOTE

**$500,000 October 6, 1998**

In consideration of the loan (hereinafter referred to as a "Loan") Safeguard Delaware, Inc., a Delaware corporation (the "Lender"), has made to Donald R. Caldwell, an individual (the "Borrower"), and for value received, the Borrower hereby promises to pay to the order of the Lender, at the Lender's office located at 103 Springer Building, 3411 Silverside Road, Wilmington, Delaware 19803, or at such other place in the continental United States as the Lender may designate in writing, in lawful money of the United States, and in immediately available funds, the principal sum of Five Hundred Thousand and no/100 Dollars ($500,000).

The unpaid principal balance of the Note shall be paid one year from the date hereof.

The Borrower hereby further promises to pay to the order of the Lender interest on the outstanding principal amount from the date hereof, at an annual rate equal to the (i) lesser of the effective lending rate that the Lender and its parent corporation are charged from time to time by PNC Bank, N. A. or the announced prime rate of PNC Bank, N.A. (the "Prime Rate") plus (ii) two percent (2%). Such interest rate shall be changed when and as the effective rate or the Prime Rate changes. In addition, the Borrower shall pay on demand interest on any overdue payment of principal and interest (to the extent legally enforceable) at the fluctuating Prime Rate plus four percent (4%).

Interest shall be payable when the unpaid principal balance of the Note is paid.

All payments made on this Note (including, without limitation, prepayments) shall be applied, at the option of the Lender, first to late charges and collection costs, if any, then to accrued interest and then to principal. Interest payable hereunder shall be calculated for actual days elapsed on the basis of a 360-day year. Accrued and unpaid interest shall be due and payable upon maturity of this Note. After maturity or in the event of default, interest shall continue to accrue on the Note at the rate set forth above and shall be payable on demand of the Lender.

The outstanding principal amount of this Note may be prepaid by the Borrower upon notice to the Lender in whole at any time or in part from time to time without any prepayment penalty or premium; provided, that upon such payment any interest due to the date of such prepayment on such prepaid amount shall also be paid.

Notwithstanding anything in this Note, the interest rate charged hereon shall not exceed the maximum rate allowable by applicable law. If any stated interest rate herein exceeds the maximum allowable rate, then the interest rate shall be reduced to the maximum allowable rate, and any excess payment of interest made by the Borrower at any time shall be applied to the unpaid balance of any outstanding principal of this Note.

An event of default hereunder shall consist of:

(i) a default in the payment by the Borrower to the Lender of principal or interest under this Note as and when the same shall become due and payable;

(ii) an event of default by the Borrower under any other obligation, instrument, note or agreement for borrowed money, beyond any applicable notice and/or grace period;

(iii) institution of any proceeding by or against the Borrower under any present or future bankruptcy or insolvency statute or similar law and, if involuntary, if the same are not stayed or dismissed within sixty (60) days, or the Borrower's assignment for the benefit of creditors or the appointment of a receiver, trustee, conservator or other judicial representative for the Borrower or the Borrower's property or the Borrower's being adjudicated a bankrupt or insolvent.

Upon the occurrence of any event of default, interest shall accrue on the outstanding balance of this Note at the Prime Rate plus four percent (4%), the entire unpaid principal amount of this Note and all unpaid interest accrued thereon shall, at the sole option of the Lender, without notice, become immediately due and payable, and the Lender shall thereupon have all the rights and remedies provided hereunder or now or hereafter available at law or in equity.

Any action, suit or proceeding where the amount in controversy as to at least one party, exclusive of interest and costs, exceeds $1,000,000 ("Summary Proceeding"), arising out of or relating to this Note, or the breach, termination or validity thereof, shall be litigated exclusively in the Superior Court of the State of Delaware (the "Delaware Superior Court") as a summary proceeding pursuant to Rules 124-131 of the Delaware Superior Court, or any successor rules (the "Summary Proceeding Rules"). Each of the parties hereto hereby irrevocably and unconditionally (i) submits to the jurisdiction of the Delaware Superior Court for any Summary Proceeding, (ii) agrees not to commence any Summary Proceeding except in the Delaware Superior Court, (iii) waives, and agrees not to plead or to make, any objection to the venue of any Summary Proceeding in the Delaware Superior Court, (iv) waives, and agrees not to plead or to make, any claim that any Summary Proceeding brought in the Delaware Superior Court has been brought in an improper or otherwise inconvenient forum,
(v) waives, and agrees not to plead or to make, any claim that the Delaware Superior Court lacks personal jurisdiction over it, (vi) waives its right to remove any Summary Proceeding to the federal courts except where such courts are vested with sole and exclusive jurisdiction by statute and (vii) understands and agrees that it shall not seek a jury trial or punitive damages in any Summary Proceeding based upon or arising out of or otherwise related to this Note and waives any and all rights to any such jury trial or to seek punitive damages.

In the event any action, suit or proceeding where the amount in controversy as to at least one party, exclusive of interest and costs, does not exceed $1,000,000 (a "Proceeding"), arising out of or relating to this Note or the breach, termination or validity thereof is brought, the parties to such Proceeding agree to make application to the Delaware Superior Court to proceed under the Summary Proceeding Rules. Until such time as such application is rejected, such Proceeding shall be treated as a Summary Proceeding and all of the foregoing provisions of this Section relating to Summary Proceedings shall apply to such Proceeding.

If a Summary Proceeding is not available to resolve any dispute hereunder, the controversy or claim shall be settled by arbitration conducted on a confidential basis, under the U.S. Arbitration Act, if applicable, and the then current Commercial Arbitration Rules of the American Arbitration Association (the "Association") strictly in accordance with the terms of this Note and the substantive law of the State of Delaware. The arbitration shall be conducted at the Association's regional office located closest to the Lender's principal place of business by three arbitrators, at least one of whom shall be knowledgeable in general business matters and one of whom shall be an attorney. Judgment upon the arbitrators' award may be entered and enforced in any court of competent jurisdiction. Neither party shall institute a proceeding hereunder unless at least 60 days prior thereto such party shall have given written notice to the other party of its intent to do so.

Neither party shall be precluded hereby from securing equitable remedies in courts of any jurisdiction, including, but not limited to, temporary restraining orders and preliminary injunctions to protect its rights and interests but such remedies shall not be sought as a means to avoid or stay arbitration or a Summary Proceeding.

The Borrower hereby waives presentment, demand, protest and notice of dishonor and protest, and also waives all other exemptions; and agrees that extension or extensions of the time of payment of this Note or any installment or part thereof may be made before, at or after maturity by agreement by the Lender. Upon default hereunder the Lender shall have the right to offset the amount owed by the Borrower against any amounts owed by the Lender in any capacity to the Borrower, whether or not due, and the Lender shall be deemed to have exercised such right of offset and to have made a charge against any such account or amounts immediately upon the occurrence of an event of default hereunder even though such charge is made or entered on the books of the Lender subsequent thereto. The Borrower shall pay to the Lender, upon demand, all costs and expenses, including, without limitation, attorneys' fees and legal expenses, that may be incurred by the Lender in connection with the enforcement of this Note.

Notices required to be given hereunder shall be deemed validly given
(i) three business days after sent, postage prepaid, by certified mail, return receipt requested, (ii) one business day after sent, charges paid by the sender, by Federal Express Next Day Delivery or other guaranteed delivery service, (iii) when sent by facsimile transmission, or (iv) when delivered by hand:

```
If to the Lender:                  Safeguard Delaware, Inc.
                                   800 The Safeguard Building
                                   435 Devon Park Drive
                                   Wayne, Pennsylvania 19087
                                   Attn: Chief Financial Officer
```

If to the Borrower: Donald R. Caldwell
531 North Rose Lane
Haverford, Pennsylvania 19041

or to such other address, or in care of such other person, as the holder or the Borrower shall hereafter specify to the other from time to time by due notice.

Any failure by the Lender to exercise any right hereunder shall not be construed as a waiver of the right to exercise the same or any other right at any time. No amendment to or modification of this Note shall be binding upon the Lender unless in writing and signed by it. Any provision hereof found to be illegal, invalid or unenforceable for any reason whatsoever shall not affect the validity, legality or enforceability of the remainder hereof. This Note shall apply to and bind the successors of the Borrower and shall inure to the benefit of the Lender, its successors and assigns.

The Note shall be governed by and interpreted in accordance with the laws of the State of Delaware.

IN WITNESS WHEREOF, the Borrower, intending to be legally bound hereby, has duly executed this Note as of the date first written above.

*/s/ Donald R. Caldwell*

---------------------

*Donald R. Caldwell*

**STOCK OPTION GRANT AGREEMENT**

CompuCom Systems, Inc., a Delaware 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 contained in this Stock Option Grant Agreement.

| | |
|---|---|
| Grant Date: | October 22, 1998 |
| Type of Option: | Non-Qualified Stock Option |
| Shares Subject to Option: | 500,000 |
| Exercise Price Per Share: | $3.1875 |
| Term of Option: | 10 years |

Shares subject to issuance under this Option do not vest until the first anniversary of the grant, and then shall vest according to the following vesting schedule:

| | |
|---|---|
| October 22, 1999 to October 21, 2000 | 25% |
| October 22, 2000 to October 21, 2001 | 50% |
| October 22, 2001 to October 21, 2002 | 75% |
| On or after October 22, 2002 | 100% |

This Option shall become exercisable by Grantee at any time following grant, subject to repurchase of any unvested Shares by the Company in the event of Grantee's termination of employment for any reason prior to the scheduled vesting date for such Shares. The purchase price for such unvested Shares shall be equal to purchase price paid for such shares. In the event Grantee exercises this Option to purchase unvested Shares, the certificate(s) representing such Shares shall be held in escrow by the Company until such time as the Shares become vested, and Grantee shall deposit with the Company a duly executed assignment separate from certificate containing a medallion signature guarantee.

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 three-month period after the Grantee ceases to be employed by, or in the service of, the Company if the termination is for any reason other than disability, death or cause;

(b) The expiration of the one-year period after the Grantee ceases to be employed by, or in the service of, 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 in the service of, 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; or

(d) The date on which the Grantee ceases to be employed by the Company for cause. For purposes of this Option, cause shall mean, except to the extent otherwise specified by the Committee, a finding by the Committee that the Grantee has breached his employment or service contract, non-competition agreement or other obligation with the Company, or has been engaged in disloyalty to the Company, including without limitation, fraud, embezzlement, theft, commission of a felony or proven dishonesty in the course of his employment of service, or has disclosed trade secrets or confidential information of the Company to persons not entitled to receive such information.

Notwithstanding the foregoing, in no event may the Option be exercised after the expiration of the Term of Option specified herein. Any portion of the Option that is not vested at the time the Grantee ceases to be employed by, or in the service of, the Company shall immediately terminate.

In the event a Grantee ceases to be employed by 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 Agreement, 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 10 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 or delivery of a promissory note. The Board 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 Board, 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 Agreement shall be subject to the rights of the Company to withhold amounts required to be withheld for any taxes, if applicable, or to deduct from other wages paid by the Company the amount of any withholding taxes due with respect to such Options. 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. 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 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 Agreement. Notwithstanding anything in this Stock Option Grant Agreement to the contrary, 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.

4. Grant Subject to Committee Authority. The grant and exercise of this Option are subject to the interpretations, regulations and determinations concerning this Option established from time to time by the Committee that administers the Company's stock options, 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, and its decisions shall be conclusive as to any questions arising hereunder.

5. No Employment Rights. The grant of the Option shall not confer upon the Grantee any right to be retained by or in the employ or service 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 Agreement or to create express or implied obligations to the Grantee of any nature.

6. 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.

7. 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 or service, including without limitation any plans regarding a public offering or merger involving the Company.

8. Assignment and Transfers. The rights and interests of the Grantee under this Stock Option Grant Agreement 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 Agreement, 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 Agreement may be assigned by the Company without the Grantee's consent.

9. Applicable Law. The validity, construction, interpretation and effect of this instrument shall be governed by and determined in accordance with the laws of the State of Delaware.

10. 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.

In witness whereof, this Stock Option Grant Agreement has been executed by the Company by a duly authorized officer as of the date specified herein.

| | |
|---|---|
| CompuCom Systems, Inc. | Accepted: |
| By: /s/ Edward R. Anderson | By:/s/ Thomas C. Lynch |
| Edward R. Anderson<br>President and Chief Executive Officer | Thomas C. Lynch, Optionee |

**ARTICLE 5**

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED BALANCE SHEET AS OF SEPTEMBER 30, 1998 AND THE CONSOLIDATED STATEMENT OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1998 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

MULTIPLIER: 1,000

| | |
|---|---|
| PERIOD TYPE | 9 MOS |
| FISCAL YEAR END | DEC 31 1998 |
| PERIOD START | JAN 01 1998 |
| PERIOD END | SEP 30 1998 |
| CASH | 4,939 |
| SECURITIES | 138,834 |
| RECEIVABLES | 263,061 |
| ALLOWANCES | 5,179 |
| INVENTORY | 144,821 |
| CURRENT ASSETS | 552,334 |
| PP&E | 137,638 |
| DEPRECIATION | 39,576 |
| TOTAL ASSETS | 996,847 |
| CURRENT LIABILITIES | 268,902 |
| BONDS | 324,839 |
| PREFERRED MANDATORY | 0 |
| PREFERRED | 0 |
| COMMON | 3,280 |
| OTHER SE | 284,959 |
| TOTAL LIABILITY AND EQUITY | 996,847 |
| SALES | 1,449,220 |
| TOTAL REVENUES | 1,781,805 |
| CGS | 1,295,217 |
| TOTAL COSTS | 1,430,510 |
| OTHER EXPENSES | 0 |
| LOSS PROVISION | 0 |
| INTEREST EXPENSE | 21,145 |
| INCOME PRETAX | 116,980 |
| INCOME TAX | 39,712 |
| INCOME CONTINUING | 70,328 |
| DISCONTINUED | 0 |
| EXTRAORDINARY | 0 |
| CHANGES | 0 |
| NET INCOME | 70,328 |
| EPS PRIMARY | 2.20 |
| EPS DILUTED | 2.04 |

**End of Filing**