SAFEGUARD SCIENTIFICS INC
Form 10-Q
October 28, 2011

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q
Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the Quarter Ended September 30, 2011
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	**19087**
(Address of principal executive offices)	*(Zip Code)*

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities 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 þ No o

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Yes o No þ

Number of shares outstanding as of October 27, 2011
Common Stock 20,723,287

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED BALANCE SHEETS

	September 30, 2011	December 31, 2010 (As Revised, See Note 13)
	(In thousands except per share data) (Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 144,241	$ 183,419
Cash held in escrow	6,433	6,434
Marketable securities	121,118	42,411
Restricted cash equivalents	5,137	4,893
Prepaid expenses and other current assets	1,253	785
Total current assets	278,182	237,942
Property and equipment, net	260	295
Ownership interests in and advances to partner companies	117,417	60,256
Available-for-sale securities	5,694	25,447
Long-term marketable securities	15,019	
Long-term restricted cash equivalents	7,128	11,881
Other	585	724
Total Assets	$ 424,285	$ 336,545
LIABILITIES AND EQUITY		
Current Liabilities:		
Convertible senior debentures current	$	$ 31,289
Accounts payable	238	493
Accrued compensation and benefits	3,495	4,168
Accrued expenses and other current liabilities	4,033	4,223
Total current liabilities	7,766	40,173
Other long-term liabilities	4,133	5,311
Convertible senior debentures non-current	45,531	44,630
Commitments and contingencies		
Equity:		
Preferred stock, $0.10 par value; 1,000 shares authorized		
Common stock, $0.10 par value; 83,333 shares authorized; 20,728 and 20,630 shares issued and outstanding in 2011 and 2010, respectively	2,073	2,063
Additional paid-in capital	810,404	806,859
Accumulated deficit	(440,171)	(575,307)

Accumulated other comprehensive income		(5,451)		12,816
Total equity		366,855		246,431
Total Liabilities and Equity	$	424,285	$	336,545

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010 (As Revised, See Note 13)	2011	2010 (As Revised, See Note 13)
	(In thousands except per share data) (Unaudited)			
General and administrative expense	$ 5,100	$ 4,256	$ 15,554	$ 13,999
Operating loss	(5,100)	(4,256)	(15,554)	(13,999)
Other income (loss), net	(324)	8,144	(1,391)	11,255
Interest income	278	180	969	516
Interest expense	(1,445)	(1,674)	(4,522)	(4,061)
Equity income (loss)	28,922	(1,798)	155,634	(12,243)
Net income (loss) before income taxes	22,331	596	135,136	(18,532)
Income tax expense (benefit)				
Net income (loss)	$ 22,331	$ 596	$ 135,136	$ (18,532)
Net income (loss) per share:				
Basic	$ 1.07	$ 0.03	$ 6.52	$ (0.90)
Diluted	$ 0.98	$ 0.03	$ 5.68	$ (0.90)
Average shares used in computing income (loss) per share:				
Basic	20,790	20,583	20,737	20,502
Diluted	24,291	21,403	24,573	20,502

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2011	2010
	(In thousands) (Unaudited)	
Cash Flows from Operating Activities:		
Net cash used in operating activities	$ (13,584)	$ (12,276)
Cash Flows from Investing Activities:		
Proceeds from sales of and distributions from companies and funds	171,167	2,760
Advances to partner companies	(3,150)	(6,116)
Repayment of advances to partner companies	5,000	1,300
Acquisitions of ownership interests in partner companies and funds	(74,692)	(18,584)
Increase in marketable securities	(160,032)	(33,294)
Decrease in marketable securities	66,306	45,966
Investment in restricted cash equivalents for interest on convertible senior debentures		(18,864)
Capital expenditures	(58)	(57)
Proceeds from sale of discontinued operations, net	1	477
Other, net	107	
Net cash provided by (used in) investing activities	4,649	(26,412)
Cash Flows from Financing Activities:		
Repurchase of convertible senior debentures	(30,848)	
Issuance of Company common stock, net	605	1,013
Costs on exchange of convertible senior debentures		(866)
Net cash provided by (used in) financing activities	(30,243)	147
Net Decrease in Cash and Cash Equivalents	(39,178)	(38,541)
Cash and Cash Equivalents at beginning of period	183,419	67,347
Cash and Cash Equivalents at end of period	$ 144,241	$ 28,806

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Total	Accumulated deficit	Accumulated other comprehensive income (loss)	Common stock Shares	Common stock Amount	Additional paid-in capital
			(In thousands) (unaudited)			
Balance December 31, 2010 (As Revised, See Note 13)	$ 246,431	$ (575,307)	$ 12,816	20,630	$ 2,063	$ 806,859
Net income	135,136	135,136				
Stock options exercised, net	605			74	8	597
Issuance of restricted stock, net	105			24	2	103
Stock-based compensation expense	2,845					2,845
Other comprehensive loss	(18,267)		(18,267)			
Balance September 30, 2011	$ 366,855	$ (440,171)	$ (5,451)	20,728	$ 2,073	$ 810,404

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

The accompanying unaudited interim Consolidated Financial Statements of Safeguard Scientifics, Inc. (the Company) were prepared in accordance with accounting principles generally accepted in the United States of America and the interim financial statement rules and regulations of the SEC. In the opinion of management, these statements include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Consolidated Financial Statements. The interim operating results are not necessarily indicative of the results for a full year or for any interim period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations relating to interim financial statements. The Consolidated Financial Statements included in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Form 10-Q and included together with the Company s Consolidated Financial Statements and Notes thereto included in the Company s 2010 Annual Report on Form 10-K.

2. BASIS OF PRESENTATION

The Company s Consolidated Financial Statements included the accounts of Clarient Inc. (Clarient) in continuing operations through May 14, 2009, the date of its deconsolidation. Clarient was acquired by GE Healthcare in December 2010. The Company had elected to apply the fair value option to account for its retained interest in Clarient upon deconsolidation. Unrealized gains and losses on the mark-to-market of its holdings in Clarient and realized gains and losses on the sale of any of its holdings in Clarient were recognized in Other income (loss), net in the Consolidated Statement of Operations for all periods subsequent to the date that Clarient was deconsolidated through the date of its disposition.

The Company s ownership interests in Tengion, Inc. (Tengion) and NuPathe, Inc. (NuPathe) are accounted for as available-for-sale securities following Tengion s and NuPathe s completion of initial public offerings in April 2010 and August 2010, respectively. Available-for-sale securities are carried at fair value, based on quoted market prices, with the unrealized gains and losses, net of tax, reported as a separate component of equity. Unrealized losses are charged against net income (loss) when a decline in the fair value is determined to be other than temporary.

In February 2011, the Company increased its ownership interest in MediaMath, Inc. (MediaMath) to 22.4%, a threshold at which the Company believes it exercises significant influence. Accordingly, the Company adopted the equity method of accounting for its holdings in MediaMath. The Company has adjusted the financial statements for all prior periods presented to retrospectively apply the equity method of accounting for its holdings in MediaMath since the initial date of acquisition in July 2009 (see Note 13).

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

3. OWNERSHIP INTERESTS IN AND ADVANCES TO PARTNER COMPANIES

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

	September 30, 2011	December 31, 2010
	(In thousands) (Unaudited)	
Equity Method:		
Partner companies	$ 105,359	$ 50,561
Private equity funds	5,860	2,265
	111,219	52,826
Cost Method:		
Private equity funds	2,984	2,908
Advances to partner companies	3,214	4,522
	$ 117,417	$ 60,256
Available-for-sale securities	$ 5,694	$ 25,447

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

In the second quarter of 2011, Advanced BioHealing, Inc. (Advanced BioHealing), formerly an equity method partner company, was acquired by Shire plc, resulting in net sale proceeds to the Company of $137.9 million, excluding cash held in escrow of $7.6 million. The Company recognized a gain on sale of $129.0 million which is reflected in Equity income (loss) in the Consolidated Statement of Operations.

The Company recognized an impairment charge of $1.4 million related to SafeCentral, Inc. in the first quarter of 2011 which is reflected in Equity income (loss) in the Consolidated Statement of Operations for the nine months ended September 30, 2011, due to modifications to the strategic direction of the business and changes in executive management at SafeCentral.

The Company recognized an impairment charge of $0.4 million in the third quarter of 2011 which is reflected in Other income (loss), net, in the Consolidated Statements of Operations, representing the unrealized loss on the mark-to-market of its ownership interest in Tengion, which was previously recorded as a separate component of equity. The Company had previously recognized impairment charges of $0.3 million and $0.8 million in the first and second quarters of 2011, respectively. Following the impairment charge, the Company s adjusted cost basis in Tengion was $0.3 million. The Company determined that the decline in the value of its public holdings in Tengion was other than temporary. The Company also recognized impairment charges on its holdings in Tengion of $2.1 million and

$1.1 million in the first and third quarters of 2010 respectively.

For the three and nine months ended September 30, 2010 the Company recognized unrealized gains of $9.2 million and $22.4 million, respectively, on the mark-to-market of its holdings in Clarient which is included in Other income (loss), net in the Consolidated Statements of Operations.

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

4. ACQUISITION OF INTERESTS IN PARTNER COMPANIES AND FUNDS

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

In August 2011, the Company acquired a 36% ownership interest in Penn Mezzanine for $3.9 million. Penn Mezzanine is a mezzanine lender focused on lower middle-market, Mid-Atlantic companies. The Company expects to deploy up to $26.1 million over a several year period in lending opportunities that meet certain predefined criteria alongside existing and future Penn Mezzanine funds. The Company accounts for its interest in Penn Mezzanine under the equity method of accounting.

In August 2011, the Company funded $2.4 million of a convertible bridge loan to Swap.com. The Company had previously deployed an aggregate of $8.1 million in Swap.com and currently maintains a 45.6% ownership interest. Swap.com is an internet based business that enables users to trade books, music, movies, video games and fashion using its proprietary trade matching software. The Company accounts for its interest in Swap.com under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Swap.com was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies on the Consolidated Balance Sheets.

In July 2011, the Company purchased $1.2 million of common shares and maintains a 22.5% interest in MediaMath, Inc. (MediaMath). In February 2011, the Company deployed $9.0 million in MediaMath. In conjunction with this funding, the Company s ownership interest in MediaMath increased from 17.3% to 22.4%, a threshold at which the Company believes it exercises significant influence. Accordingly, the Company adopted the equity method of accounting for its holdings in MediaMath. See Note 13 regarding the change in accounting treatment for the Company s holdings in MediaMath from the cost method to the equity method. The Company previously had acquired an interest in MediaMath in July 2009 for $6.7 million. MediaMath is an online media trading company that enables advertising agencies and their advertisers to optimize their ad spending across various exchanges through its proprietary algorithmic bidding platform and data integration technology. The difference between the Company s cost and its interest in the underlying net assets of MediaMath was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies on the Consolidated Balance Sheets.

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

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

In April 2011, the Company funded $0.8 million of a convertible bridge loan to Alverix, Inc. (Alverix). The Company previously deployed an aggregate of $6.3 million in Alverix and currently maintains a 49.6% ownership interest. Alverix provides next-generation instrument and connectivity platforms for diagnostic Point-of-Care (POC) testing. The Company accounts for its holdings in Alverix under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Alverix was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies on the Consolidated Balance Sheets.

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

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

5. FAIR VALUE MEASUREMENTS

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

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2 Include other inputs that are directly or indirectly observable in the marketplace.
Level 3 Unobservable inputs which are supported by little or no market activity.

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

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

The following table provides the assets and liabilities measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010:

	Carrying Value	Fair Value Measurement at September 30, 2011		
		Level 1	Level 2	Level 3
		(in thousands) (unaudited)		
Cash and cash equivalents	$ 144,241	$ 144,241	$	$
Cash held in escrow	$ 6,433	$ 6,433	$	$
Restricted cash equivalents	$ 12,265	$ 12,265	$	$
Available-for-sale securities	$ 5,694	$ 5,694	$	$
Marketable securities - held-to-maturity:				
Commercial paper	$ 41,740	$ 41,740	$	$
U.S. Treasury Bills	27,593	27,593		
Government agency bonds	55,178	55,178		
Certificates of deposit	11,626	11,626		
	$ 136,137	$ 136,137	$	$

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

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

As of September 30, 2011, $121.1 million of marketable securities had contractual maturities which were less than one year and $15.0 million of marketable securities had contractual maturities greater than one year. Held-to-maturity securities are carried at amortized cost, which, due to the short-term maturity of these instruments, approximates fair value using quoted prices in active markets for identical assets or liabilities defined as Level 1 inputs under the fair value hierarchy.

The Company s holdings in Clarient during the three months and nine ended September 30, 2010 were measured at fair value using quoted prices for Clarient s common stock as traded on the NASDAQ Capital Market, which is considered a Level 1 input under the valuation hierarchy.

The Company accounts for its holdings in Tengion as available-for-sale securities. The Company recognized impairment charges of $0.4 million, $0.3 million and $0.8 million in the third, second and first quarters of 2011, respectively, representing the unrealized losses on the mark-to-market of its ownership interest in Tengion which were previously recorded as a separate component of equity. As of September 30, 2011, the Company s adjusted cost basis in available-for-sale securities of Tengion was $0.3 million. The value of the Company s holdings in Tengion was measured by reference to quoted prices for Tengion s common stock as traded on the NASDAQ Capital Market, which is considered a Level 1 input under the valuation hierarchy.

The Company recognized an impairment charge of $1.4 million related to SafeCentral in the first quarter of 2011 measured as the amount by which SafeCentral s carrying value exceeded its estimated fair value. The fair market value of SafeCentral was determined based on Level 3 inputs as defined above.

The Company accounts for its holdings in NuPathe as available-for-sale securities. As of September 30, 2011, the Company s adjusted cost basis in available-for-sale securities of NuPathe was $10.8 million. As of September 30, 2011 the Company s holdings of available-for-sale securities in NuPathe had generated an unrealized loss of $5.5 million. The value of the Company s holdings in NuPathe was measured by reference to quoted prices for NuPathe s common stock as traded on the NASDAQ Capital Market, which is considered a Level 1 input under the valuation hierarchy.

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

6. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is the change in equity of a business enterprise from transactions and other events and circumstances from non-owner sources. Excluding net income (loss), the Company s sources of comprehensive income (loss) were from changes in fair value of available-for-sale securities.

The following summarizes the components of comprehensive income (loss):

	Three Months ended September 30,	Nine Months ended S