SAFEGUARD SCIENTIFICS INC
Form 10-Q
July 26, 2013

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

þQuarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Quarter Ended June 30, 2013

¨Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Transition Period From ____________ to ___________

Commission File Number 1-5620

Safeguard Scientifics, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	23-1609753 (I.R.S. Employer ID No.)
435 Devon Park Drive Building 800 Wayne, PA (Address of principal executive offices)	19087 (Zip Code)

(610) 293-0600

Registrant s telephone number, including area code

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities 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 ¨

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

Yes þ No ¨

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

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

Yes ¨ No þ

Number of shares outstanding as of July 25, 2013

Common Stock 26,976,963

SAFEGUARD SCIENTIFICS, INC.

QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 102,732	$ 66,029
Cash held in escrow		6,434
Marketable securities	70,231	110,957
Restricted marketable securities	6	10
Prepaid expenses and other current assets	1,334	2,408
Total current assets	174,303	185,838
Property and equipment, net	164	193
Ownership interests in and advances to partner companies and funds (of which $ 19,363 and $20,972 are measured at fair value at June 30, 2013 and December 31, 2012, respectively)	143,100	148,639
Loan participations receivable	8,310	7,085
Available-for-sale securities	18	58
Long-term marketable securities	7,146	29,059
Other assets	3,077	3,272
Total Assets	$ 336,118	$ 374,144
LIABILITIES AND EQUITY		
Current Liabilities:		
Convertible senior debentures current	$ 470	$
Accounts payable	203	610
Accrued compensation and benefits	3,634	4,050
Accrued expenses and other current liabilities	3,631	2,601
Total current liabilities	7,938	7,261
Other long-term liabilities	3,862	3,921
Convertible senior debentures non-current	48,970	48,991
Total Liabilities	60,770	60,173
Commitments and contingencies		
Equity:		
Preferred stock, $0.10 par value; 1,000 shares authorized		
Common stock, $0.10 par value; 83,333 shares authorized; 20,977 and 20,968 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	2,098	2,097
Additional paid-in capital	817,384	815,946
Accumulated deficit	(544,134)	(504,072)
Total Equity	275,348	313,971
Total Liabilities and Equity	$ 336,118	$ 374,144

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited In thousands, except per share data)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
General and administrative expense	$ 6,715	$ 5,148	$ 12,089	$ 9,891
Operating loss	(6,715)	(5,148)	(12,089)	(9,891)
Other income (loss), net	(2,724)	4,819	(1,967)	7,903
Interest income	790	595	1,524	1,494
Interest expense	(1,074)	(1,456)	(2,143)	(2,908)
Equity loss	(18,400)	(8,947)	(25,387)	(16,395)
Net loss before income taxes	(28,123)	(10,137)	(40,062)	(19,797)
Income tax benefit (expense)				
Net loss	$ (28,123)	$ (10,137)	$ (40,062)	$ (19,797)
Net loss per share:				
Basic	$ (1.33)	$ (0.48)	$ (1.90)	$ (0.95)
Diluted	$ (1.33)	$ (0.48)	$ (1.90)	$ (0.95)
Weighted average shares used in computing basic and diluted loss per share:	21,128	20,927	21,119	20,903

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net loss	$ (28,123)	$ (10,137)	$ (40,062)	$ (19,797)
Other comprehensive income (loss), before taxes:				
Unrealized net gain (loss) on available-for-sale securities	(26)	734	(40)	5,800
Reclassification adjustment for other than temporary impairment of available-for-sale securities included in net loss	26	144	40	144
Total comprehensive loss	$ (28,123)	$ (9,259)	$ (40,062)	$ (13,853)

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited In thousands)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Cash Flows from Operating Activities:		
Net cash used in operating activities	$ (11,540)	$ (9,624)
Cash Flows from Investing Activities:		
Proceeds from sales of and distributions from companies and funds	1,403	11,061
Advances and loans to companies	(8,100)	(5,141)
Origination fees on mezzanine loans	42	46
Acquisitions of ownership interests in companies and funds	(15,131)	(16,190)
Increase in marketable securities	(29,913)	(141,997)
Decrease in marketable securities	92,552	133,751
Repayment of advances and loans to companies	928	3,144
Capital expenditures	(21)	(25)
Proceeds from sale of discontinued operations, net	6,434	
Net cash provided by (used in) investing activities	48,194	(15,351)
Cash Flows from Financing Activities:		
Repurchase of convertible senior debentures	(43)	
Issuance of Company common stock, net	92	513
Net cash provided by financing activities	49	513
Net Increase (Decrease) in Cash and Cash Equivalents	36,703	(24,462)
Cash and Cash Equivalents at beginning of period	66,029	83,187
Cash and Cash Equivalents at end of period	$ 102,732	$ 58,725

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(Unaudited In thousands)

	Total Equity	Accumulated Deficit	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital
Balance December 31, 2012	$ 313,971	$ (504,072)	20,968	$ 2,097	$ 815,946
Net loss	(40,062)	(40,062)			
Stock options exercised, net	92		9	1	91
Issuance of restricted stock, net	49				49
Stock-based compensation expense	1,298				1,298
Balance June 30, 2013	$ 275,348	$ (544,134)	20,977	$ 2,098	$ 817,384

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. General

The accompanying unaudited interim Consolidated Financial Statements of Safeguard Scientifics, Inc. (Safeguard or 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 note 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 with the Company s Consolidated Financial Statements and Notes thereto included in the Company s 2012 Annual Report on Form 10-K.

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

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

	June 30, 2013	December 31, 2012
	(In thousands)	
	(Unaudited)	
Fair value	$ 19,363	$ 20,972
Equity Method:		
Partner companies	98,997	102,931
Private equity funds	3,714	3,810
	102,711	106,741
Cost Method:		
Partner companies	13,030	10,000
Private equity funds	2,484	2,634
	15,514	12,634
Advances to partner companies	5,512	8,292
	$ 143,100	$ 148,639
Loan participations receivable	$ 8,310	$ 7,085

Available-for-sale securities	$	18	$	58

The Company recognized impairment charges of $9.9 million and $3.7 million related to PixelOptics Inc. (PixelOptics) in the three months ended June 30, 2013 and 2012, respectively, which are reflected in Equity loss in the Consolidated Statements of Operations. The impairment in 2013 was based on the decision of PixelOptics to seek additional capital from independent sources as well as the Company s decision to deploy no substantial additional capital in PixelOptics. The impairment in 2012 was based upon launch delays and related supply chain issues, as well as the pricing of a transaction between other institutional shareholders in PixelOptics.

The Company recorded impairment charges of $0.3 million and $0.7 million related to its Penn Mezzanine debt and equity participations in the three months ended June 30, 2013 and 2012, respectively, which are reflected in Other income (loss), net in the Consolidated Statements of Operations. In the three months ended June 30, 2013, the charge included $0.2 million related to loan participations and $0.1 million representing an adjustment to the fair value of the Company s participation in warrants. In the three months ended June 30, 2012, the charge included $0.2 million related to loan participations, $0.4 million related to equity participations and $0.1 million representing an adjustment to the fair value of the Company s participation in warrants.

The Company recognized impairment charges of $0.2 million and $0.4 million related to its interest in a legacy private equity fund in the first quarter of 2013 and 2012, respectively, which are reflected in Other income (loss), net in the Consolidated Statements of Operations.

SAFEGUARD SCIENTIFICS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the three and six months ended June 30, 2013, the Company recognized an unrealized loss of $2.4 million and $1.6 million, respectively, on the mark-to-market of its holdings in NuPathe, Inc. (NuPathe), which is included in Other income (loss), net in the Consolidated Statements of Operations.

The following unaudited summarized results of operations for the three months ended March 31, 2013 and 2012 for PixelOptics have been compiled from the unaudited financial statements of PixelOptics.

The results of PixelOptics are reported on a one quarter lag.

	Three Months Ended March 31,	
	2013	2012
	(In thousands) (Unaudited)	
Results of Operations:		
Revenue	$ 539	$ 307
Operating loss	$ (5,855)	$ (8,721)
Net loss	$ (7,061)	$ (9,012)

3. Acquisitions of Ownership Interests in Partner Companies and Funds

During the six months ended June 30, 2013, the Company funded $2.3 million for participations in loan and equity interests initiated by Penn Mezzanine. Included in this funding were $2.2 million for participation in a loan and $0.1 million for participation in equity of the borrower acquired by Penn Mezzanine.

During the six months ended June 30, 2013, the Company funded an aggregate of $5.3 million of a convertible bridge loan to PixelOptics. The Company previously deployed an aggregate of $31.6 million in PixelOptics. 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.

In June 2013, the Company deployed an additional $5.3 million into Medivo, Inc. (Medivo). The Company had previously acquired an interest in Medivo in November 2011 for $6.3 million. Medivo is a healthcare IT company that connects patients to a nationwide network of physicians, lab service centers and home testing services. The Company accounts for its interest in Medivo under the equity method. With respect to the June 2013 deployment, the difference between the Company s cost and its interest in the underlying net assets of Medivo was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In June 2013, the Company funded $0.3 million of a convertible bridge loan to Alverix, Inc (Alverix). The Company had previously deployed an aggregate of $8.8 million in Alverix. Alverix provides next-generation instrument and connectivity platforms for diagnostic Point-of-Care testing. The Company accounts for its interest in Alverix under the equity method.

In May 2013, the Company funded $0.2 million of a convertible bridge loan to Hoopla Software, Inc. (Hoopla). The Company had previously acquired an interest in Hoopla in December 2011 for $1.3 million. Hoopla helps organizations create high performance sales cultures through software-as-a-service solutions that integrate with customer relationship management systems. The Company accounts for its interest in Hoopla under the equity method.

In March 2013, the Company deployed an additional $1.7 million into Lumesis, Inc. (Lumesis). The Company had previously acquired an interest in Lumesis in February 2012 for $2.2 million. Lumesis is a financial technology company that is dedicated to delivering timely data and robust analytical tools for the fixed income marketplace. The Company accounts for its interest in Lumesis under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Lumesis was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In February 2013, the Company acquired a 6.5% ownership interest in Clutch Holdings, LLC (Clutch) for $0.5 million. Clutch is a mobile commerce platform that unifies applications associated with gifting, loyalty and shopping programs to improve the customer experience. The Company accounts for its interest in Clutch under the cost method.

In February 2013, the Company acquired a 27.6% ownership interest in Pneuron, Inc. (Pneuron) for $5.0 million. Pneuron helps enterprise companies reduce the time and cost of application development by building solutions across heterogeneous databases and applications. The Company accounts for its ownership interest in Pneuron under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Pneuron was preliminarily allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to partner companies and funds on the Consolidated Balance Sheets.

In January 2013, the Company acquired a 7.7% interest in Sotera Wireless, Inc. (Sotera). The Company deployed $1.3 million into Sotera and acquired additional shares from a previous investor for $1.2 million. Sotera is a medical device company that has developed a wireless patient monitoring platform that is designed to keep clinicians connected to their patients. The Company accounts for its interest in Sotera under the cost method.

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

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

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

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

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

The following table provides the carrying value and fair value of certain financial assets and liabilities of the Company measured at fair value on a recurring basis as of June 30, 2013 and December 31, 2012:

	Carrying Value	Fair Value Measurement at June 30, 2013 Level 1	Level 2	Level 3

		(In thousands) (Unaudited)		
Cash and cash equivalents	$ 102,732	$ 102,732	$	$
Cash held in escrow				
Restricted marketable securities	6	6		
Ownership interest in common stock of NuPathe	15,791	15,791		
Ownership interest in warrants and options of NuPathe	3,572			3,572
Available-for-sale securities	18	18		
Warrant participations	417			417
Marketable securities held-to-maturity:				
Commercial paper	$ 19,237	$ 19,237	$	$
U.S. Treasury Bills	18,180	18,180		
Government agency bonds	22,166	22,166		
Certificates of deposit	17,794	17,794		