SAFEGUARD SCIENTIFICS INC
Form 10-Q
May 10, 2010

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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 March 31, 2010
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 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 o 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 Smaller reporting company o
(Do not check if a smaller reporting company)

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 May 5, 2010
Common Stock 20,493,544

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2010	December 31, 2009
	(In thousands except per share data) (Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 38,177	$ 67,347
Cash held in escrow	6,433	6,910
Marketable securities	39,603	39,066
Restricted cash equivalents	4,752	
Prepaid expenses and other current assets	2,141	566
Total current assets	91,106	113,889
Property and equipment, net	281	310
Ownership interests in and advances to partner companies ($79,549 and $80,483 at fair value at March 31, 2010 and December 31, 2009 respectively)	162,135	167,387
Long-term restricted cash equivalents	14,257	
Other	827	513
Total Assets	$ 268,606	$ 282,099
LIABILITIES AND EQUITY		
Current Liabilities:		
Convertible senior debentures current	$ 31,289	$
Accounts payable	343	156
Accrued compensation and benefits	1,595	3,425
Accrued expenses and other current liabilities	4,269	4,325
Total current liabilities	37,496	7,906
Other long-term liabilities	5,409	5,461
Convertible senior debentures non-current	44,215	78,225
Commitments and contingencies		
Equity:		
Preferred stock, $0.10 par value; 1,000 shares authorized		
Common stock, $0.10 par value; 83,333 shares authorized; 20,479 and 20,420 shares issued and outstanding in 2010 and 2009, respectively	2,048	2,042
Additional paid-in capital	803,126	790,868
Accumulated deficit	(623,688)	(601,916)
Treasury stock, at cost		(487)
Total equity	181,486	190,507
Total Liabilities and Equity	$ 268,606	$ 282,099

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31, 2010	2009
	(In thousands except per share data) (Unaudited)	
Revenue	$	$ 23,192
Operating Expenses:		
Cost of sales		8,966
Selling, general and administrative	4,833	17,089
Total operating expenses	4,833	26,055
Operating loss	(4,833)	(2,863)
Other income (loss), net	(11,297)	(245)
Interest income	97	157
Interest expense	(730)	(926)
Equity Loss	(5,009)	(5,513)
Net loss from continuing operations before income taxes	(21,772)	(9,390)
Income tax (expense) benefit		
Net loss from continuing operations	(21,772)	(9,390)
Income from discontinued operations, net of tax		1,500
Net loss	(21,772)	(7,890)
Net (income) loss attributable to noncontrolling interest		(1,139)
Net loss attributable to Safeguard Scientifics, Inc.	$ (21,772)	$ (9,029)
Basic and Diluted Income (Loss) Per Share:		
Net loss from continuing operations attributable to Safeguard Scientifics, Inc. common shareholders	$ (1.07)	$ (0.49)
Net income (loss) from discontinued operations attributable to Safeguard Scientifics, Inc. common shareholders		0.04
Net loss attributable to Safeguard Scientifics, Inc. common shareholders	$ (1.07)	$ (0.45)
Shares used in computing basic and diluted income (loss) per share	20,392	20,274
Amounts attributable to Safeguard Scientifics, Inc. common shareholders:		
Loss from continuing operations	$ (21,772)	$ (9,924)
Income from discontinued operations		895

Net loss attributable to Safeguard Scientifics, Inc.	$	(21,772)	$	(9,029)

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2010	2009
	(In thousands) (Unaudited)	
Cash Flows from Operating Activities:		
Net cash used in operating activities	$ (6,970)	$ (6,816)
Cash Flows from Investing Activities:		
Investment in restricted cash equivalents for interest on convertible senior debentures	(19,009)	
Proceeds from sales of and distributions from companies and funds	2,755	
Advances to partner companies	(2,025)	(250)
Acquisitions of ownership interests in partner companies and funds, net of cash acquired	(4,812)	(3,268)
Increase in marketable securities	(11,305)	(5,783)
Decrease in marketable securities	10,768	14,050
Increase in restricted cash, net		(1,953)
Capital expenditures		(1,783)
Proceeds from sale of discontinued operations, net	477	
Net cash provided by (used in) investing activities	(23,151)	1,013
Cash Flows from Financing Activities:		
Costs on exchange of convertible senior debentures	(150)	
Borrowings on revolving credit facilities		15,945
Repayments on revolving credit facilities		(24,162)
Repayments on term debt		(64)
Issuance of Company common stock, net	1,101	
Issuance of subsidiary equity, net		28,082
Net cash provided by financing activities	951	19,801
Net Increase (Decrease) in Cash and Cash Equivalents	(29,170)	13,998
Cash and Cash Equivalents at beginning of period	67,347	75,051
Cash and Cash Equivalents at end of period	$ 38,177	$ 89,049

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Total	Accumulated Deficit	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount
			(In thousands) (unaudited)				
Balance December 31, 2009	$ 190,507	$ (601,916)	20,420	$ 2,042	$ 790,868	44	$ (487)
Net loss	(21,772)	(21,772)					
Stock options exercised, net	470		36	4	292	(16)	174
Issuance of restricted stock, net	41				41	2	
Stock-based compensation expense	738				738		
Equity component of convertible senior debentures issued, net of issuance costs	10,871				10,871		
Stock awards	631		24	2	316	(30)	313
Balance March 31, 2010	$ 181,486	$ (623,688)	20,480	$ 2,048	$ 803,126		$

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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 statements 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 2009 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. The Company has elected to apply the fair value option to account for its retained interest in Clarient. 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 are recognized in Other income (loss), net in the Consolidated Statement of Operations for all periods subsequent to the date that Clarient was deconsolidated. The Company believes that accounting for its holdings in Clarient at fair value rather than applying the equity method of accounting provides a better measure of the value of its holdings, given the reliable evidence provided by quoted prices in an active market for Clarient s publicly traded common stock. The Company has not elected the fair value option for its other partner company holdings, which are accounted for under the equity method or cost method, due to less readily determinable evidence of fair value for these privately held companies and due to the potential competitive disadvantage to the Company of such disclosure.

The Company s voting interest in Cellumen, Inc. (Cellumen) was 58.8% as of March 31, 2010, on an as-converted basis. Due to the substantive participating rights of the minority shareholders in the significant operating decisions of Cellumen, the Company continues to account for its holdings in Cellumen under the equity method.

All share and per share amounts have been restated for the three months ended March 31, 2009 to reflect the one-for-six reverse split of the Company s common stock, which became effective on August 27, 2009.

3. DISCONTINUED OPERATIONS

Clarient Technology Business

In March 2007, Clarient sold its technology business and related intellectual property to Carl Zeiss MicroImaging, Inc. (Zeiss) for an aggregate purchase price of $12.5 million. The $12.5 million consisted of $11.0 million in cash and an additional $1.5 million in contingent purchase price, subject to the satisfaction of certain post-closing conditions through March 2009. Clarient received the contingent consideration and recorded the $1.5 million in income from discontinued operations in the three months ended March 31, 2009.

Pacific Title & Art Studio

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

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

4. 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 accounted for under the fair value, equity or cost method of accounting.

	March 31, 2010	December 31, 2009
	(In thousands)	
	(Unaudited)	
Fair Value:	$ 79,549	$ 80,483
Equity Method:		
Partner companies	54,633	54,597
Private equity funds	2,237	2,224
	56,870	56,821
Cost Method:		
Partner companies	20,079	24,887
Private equity funds	3,096	3,096
	23,175	27,983
Advances to partner companies	2,541	2,100
	$ 162,135	$ 167,387

The Company recognized an impairment charge of $2.1 million related to Tengion Inc. (Tengion), a cost method partner company, in the three months ended March 31, 2010, which is reflected in Other income (loss), net in the Consolidated Statements of Operations. Upon Tengion s completion of its initial public offering in April 2010, the Company compared the carrying value of its holdings to the market price for Tengion s shares in its IPO. The Company determined that there had been an other than temporary decline in the value of its holdings in Tengion and the impairment charge was measured as the amount by which Tengion s carrying value exceeded its estimated fair value. In conjunction with Tengion s IPO, the Company deployed an additional $1.5 million in Tengion in April 2010.

On March 25, 2009, Clarient entered into a stock purchase agreement with Oak Investment Partners XII (Oak), pursuant to which Clarient agreed to sell up to an aggregate of 6.6 million shares of its Series A Convertible Preferred Stock in two or more tranches for aggregate consideration of up to $50.0 million. Each preferred share is initially convertible, at any time, into four shares of Clarient s common stock, subject to certain adjustments. The initial closing of the Oak private placement occurred on March 26, 2009, at which time Clarient issued 3.8 million preferred shares for aggregate consideration of $29.1 million. After paying closing fees and legal expenses, Clarient used the proceeds to repay in full and terminate its revolving credit agreement with a bank and repay a portion of the outstanding balance of its credit facility with the Company. During the first quarter of 2009, the Company accounted for the change in the Company s ownership interest in Clarient as an equity transaction because the Company retained its controlling financial interest in Clarient.

On May 14, 2009, Clarient completed the second closing of the Oak private placement and issued 1.4 million preferred shares for aggregate consideration of $10.9 million. Upon completion of the second closing, Clarient repaid in full and terminated its credit facility with the Company. Upon the second closing, the Company s ownership interest in Clarient s issued and outstanding voting securities, on an as-converted basis, decreased from 50.2% to 47.3% and the Company deconsolidated its holdings in Clarient because it ceased to have a controlling financial interest in

Clarient as of such date. The Company recognized an unrealized gain on deconsolidation of $106.0 million in Other income (loss), net in the Consolidated Statements of Operations in the three months ended June 30, 2009. The entire unrealized gain on deconsolidation related to the remeasurement to fair value of the Company s retained interest in Clarient as of the deconsolidation date of May 14, 2009.

For the three months ended March 31, 2010 the Company recognized an unrealized loss of $0.9 million 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)

The following unaudited summarized financial information for Clarient for the three months ended December 31, 2009 and 2008, respectively, has been compiled from the unaudited financial statements of Clarient. The results of Clarient are reported on a one quarter lag.

	December 31, 2009 (In thousands) (unaudited)
Balance Sheet:	
Current assets	$ 35,462
Non-current assets	31,485
Total Assets	$ 66,947
Current liabilities	$ 14,175
Non-current liabilities	44,895
Shareholders equity	7,877
Total Liabilities and Shareholders Equity	$ 66,947

	Three Months Ended December 31, 2009	2008
	(In thousands) (unaudited)	
Results of Operations:		
Revenue	$ 23,252	$ 21,937
Operating income (loss)	$ (2,315)	$ 184
Net loss from continuing operations	$ (2,690)	$ (2,218)

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

5. Acquisition of Ownership Interests in Partner Companies

In March 2010, the Company deployed an additional $4.7 million in Swaptree Inc. (Swaptree) in connection with a larger round of financing, resulting in an increase in the Company s ownership interest from 29.3% to 46.6%. The Company had previously acquired an interest in Swaptree in July 2008 for $3.4 million in cash. Swaptree is an internet-based business that enables users to trade books, CDs, DVDs and video games using its proprietary trade matching software. The Company accounts for its holdings in Swaptree under the equity method. The difference between the Company s cost and its interest in the underlying net assets of Swaptree was allocated to intangible assets and goodwill as reflected in the carrying value in Ownership interests in and advances to companies on the Consolidated Balance Sheets.

In March 2010, the Company funded a $1.3 million short-term loan to Advantedge Healthcare Solutions, Inc. (AHS). The Company previously deployed a total of $13.5 million into AHS and maintains a 39.7% ownership interest. The Company accounts for its holdings in AHS under the equity method.

In January 2010, The Company funded a $0.6 million convertible bridge loan to Alverix, Inc. (Alverix). The Company previously deployed an aggregate of $4.5 million in Alverix and maintains a 50.0% ownership interest. Alverix is an optoelectronics company that produces novel, handheld readers with the accuracy and precision of laboratory instruments. The Company accounts for its holdings in Alverix under the equity method.

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

6. FAIR VALUE MEASUREMENTS

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

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

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

The following table provides the assets and liabilities measured at fair value on a recurring basis as of March 31, 2010 and December 31, 2009:

	Carrying Value	Fair Value Measurement at March 31, 2010		
		Level 1	Level 2	Level 3
	(in thousands)			
Cash and cash equivalents	$ 38,117	$ 38,117	$	$
Cash held in escrow	$ 6,433	$ 6,433	$	$
Restricted cash equivalents	$ 19,009	$ 19,009	$	$
Ownership interest in Clarient	$ 79,549	$ 79,549	$	$
Marketable securities held-to-maturity:				
Commercial paper	$ 7,290	$ 7,290	$	$
U.S. Treasury Bills	7,983	7,983		
Government agency bonds	9,009	9,009		
Certificates of deposit	15,321	15,321		
	$ 39,603	$ 39,603	$	$

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

	Carrying Value	Fair Value Measurement at December 31, 2009 Level 1	Level 2	Level 3
		(in thousands)		
Cash and cash equivalents	$ 67,347	$ 67,347	$	$
Cash held in escrow	$ 6,910	$ 6,910	$	$
Ownership interest in Clarient	$ 80,483	$ 80,483	$	$
Marketable securities held-to-maturity:				
Commercial paper	$ 10,380	$ 10,380	$	$
U.S. Treasury Bills	4,981	4,981		
Government agency bonds	8,384	8,384		
Certificates of deposit	15,321	15,321		
	$ 39,066	$ 39,066	$	$

As of March 31, 2010, the contractual maturities of the marketable securities were less 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 are measured at fair value using quoted prices for Clarient s common stock as traded on the NAS