

SAFEGUARD SCIENTIFICS INC

Form 10-K/A

April 29, 2008

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K/A
Amendment No. 2
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2007
Commission File Number 1-5620
Safeguard Scientifics, Inc.
(Exact name of Registrant as specified in its charter)

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

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

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

19087
(Zip Code)

(610) 293-0600

(Registrant's telephone number, including area code)

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

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

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

None

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

Yes ☐ No ☒

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

Yes ☐ No ☒

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

Yes ☒ No ☐

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the 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 ☒ 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 ☐

As of June 30, 2007, the aggregate market value of the Registrant's common stock held by non-affiliates of the registrant was \$338,086,524 based on the closing sale price as reported on the New York Stock Exchange.

The number of shares outstanding of the Registrant's Common Stock, as of April 25, 2008 was 121,564,111.

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Explanatory Note

Safeguard Scientifics, Inc. (Safeguard, the Company, we, us, and our) is filing this Amendment No. 2 on Form 10-K/A for the year ended December 31, 2007 (Form 10-K/A) to amend our Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission (the SEC) on March 31, 2008 (the Original 10-K). The Company is hereby amending the Form 10-K as follows:

To include Part III of the Original 10-K in its entirety (which includes an updated list of the Company's executive officers that was initially included as an Annex to Part I of the Original 10-K), which items were originally expected to be incorporated by reference in our definitive proxy statement to be delivered to our shareholders in connection with our 2008 annual meeting of shareholders;

To amend and restate Item 8 of the Original 10-K to correct the last paragraph of the report of our independent registered public accounting firm on the company's consolidated financial statements, which report appears on page 3, that incorrectly referred to an unqualified audit report on the effectiveness of the Company's internal control over financial reporting when the report of our independent registered public accounting firm on internal control over financial reporting, which report appears on page 2, expressed an adverse opinion on the effectiveness of internal control over financial reporting; Although we are required to file the complete text of Item 8 in accordance with Rule 12b-15 under the Securities and Exchange Act of 1934, there has been no change to the financial statements other than the referenced change in the audit report of our independent registered public accounting firm; and

On the cover page, (i) to delete the reference in the Original 10-K to the incorporation by reference of the Company's proxy statement for its 2008 annual shareholders' meeting and (ii) to update the date as of which the number of outstanding shares of the Company's common stock is being provided.

This Form 10-K/A does not reflect events that occurred after the filing of the Original 10-K. As a result of this amendment, we also are filing the certifications pursuant to Section 302 and Section 906 of the Sarbanes-Oxley Act of 2002 as exhibits to this Form 10-K/A. These certifications are included as Exhibits 31.3, 31.4, 32.3 and 32.4. Except for the amendments and updates described above, this Amendment No. 2 on Form 10-K/A does not modify or update in any other way the Original 10-K.

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Item 8. *Financial Statements and Supplementary Data*

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

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Safeguard Scientifics, Inc.:

We have audited Safeguard Scientifics, Inc.'s (the Company) internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Safeguard Scientifics, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting (Item 9A.(b)). Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses related to the following have been identified and included in management's assessment: (i) Ineffective policies and procedures for ensuring financial reporting risks are identified timely and corresponding control activities implemented and (ii) the combined effect of significant deficiencies related to accounting for refunds due to customers and the allowance for doubtful accounts.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Safeguard Scientifics, Inc. as of December 31, 2007 and 2006, and the related consolidated statements of operations, comprehensive income (loss), shareholder's equity and cash flows for each of the years in the three-year period ended December 31, 2007. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 consolidated financial statements, and this report does not affect our report dated March 31, 2008, which expressed an unqualified opinion on those consolidated financial statements.

In our opinion, because of the effect of the aforementioned material weaknesses on the achievement of the objectives of the control criteria, Safeguard Scientifics, Inc. has not maintained effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ KPMG LLP

Philadelphia, Pennsylvania

March 31, 2008

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Safeguard Scientifics, Inc.:

We have audited the accompanying consolidated balance sheets of Safeguard Scientifics, Inc. (the Company) and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Safeguard Scientifics, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*, effective January 1, 2007. Also, as discussed in Note 12 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, effective January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Safeguard Scientifics, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 31, 2008 expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Philadelphia, Pennsylvania

March 31, 2008

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED BALANCE SHEETS

	As of December 31, 20072006 (In thousands except per share data)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 99,965	\$ 67,012
Cash held in escrow current	20,345	
Marketable securities	590	94,155
Restricted marketable securities	3,904	3,869
Accounts receivable, less allowances (\$3,818 2007; \$1,713 2006)	37,578	33,481
Prepaid expenses and other current assets	6,000	5,080
Current assets of discontinued operations		11,703
Total current assets	168,382	215,300
Property and equipment, net	35,573	34,209
Ownership interests in and advances to companies	92,985	54,548
Long-term marketable securities		487
Long-term restricted marketable securities	1,949	5,737
Intangible assets, net	9,960	11,984
Goodwill	76,824	80,418
Cash held in escrow long term	2,341	19,398
Other	3,848	3,764
Non-current assets of discontinued operations		17,850
Total Assets	\$ 391,862	\$ 443,695
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Current portion of credit line borrowings	\$ 40,012	\$ 25,014
Current maturities of long-term debt	3,752	3,192
Accounts payable	7,654	10,581
Accrued compensation and benefits	13,467	13,432
Accrued expenses and other current liabilities	18,925	19,256
Deferred revenue	6,100	3,560
Current liabilities of discontinued operations		3,465
Total current liabilities	89,910	78,500
Long-term debt	4,746	4,010
Other long-term liabilities	9,765	10,319
Convertible senior debentures	129,000	129,000
Deferred taxes	1,026	1,026

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Minority interest	2,692	5,404
Non-current liabilities of discontinued operations		1,656
Commitments and contingencies Redeemable consolidated partner company stock-based compensation	84	2,021
Shareholders' Equity:		
Preferred stock, \$0.10 par value; 1,000 shares authorized		
Common stock, \$0.10 par value; 500,000 shares authorized; 121,123 and 120,419 shares issued and outstanding in 2007 and 2006, respectively	12,112	12,042
Additional paid-in capital	758,515	750,361
Accumulated deficit	(616,013)	(551,180)
Accumulated other comprehensive income	25	536
Total shareholders' equity	154,639	211,759
Total Liabilities and Shareholders' Equity	\$ 391,862	\$ 443,695

See Notes to Consolidated Financial Statements.

Table of Contents**SAFEGUARD SCIENTIFICS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

	Year Ended December 31,		
	2007	2006	2005
	(In thousands except per share data)		
Revenue	\$ 176,119	\$ 162,642	\$ 103,775
Operating Expenses:			
Cost of sales	124,739	118,749	81,437
Selling, general and administrative	97,108	93,016	66,309
Research and development	2,407	2,501	125
Purchased in-process research and development			1,974
Amortization of intangible assets	2,024	2,498	1,092
Goodwill impairment	5,438		
Total operating expenses	231,716	216,764	150,937
Operating loss	(55,597)	(54,122)	(47,162)
Other income (loss), net	(4,866)	5,559	7,066
Recovery related party	12	360	28
Interest income	7,539	6,907	4,974
Interest expense	(7,660)	(6,630)	(6,365)
Equity loss	(14,143)	(3,267)	(6,597)
Minority interest	5,829	6,112	6,922
Net loss from continuing operations before income taxes	(68,886)	(45,081)	(41,134)
Income tax benefit	781	1,186	230
Net loss from continuing operations	(68,105)	(43,895)	(40,904)
Income from discontinued operations, net of tax	3,272	89,803	8,834
Net income (loss)	\$ (64,833)	\$ 45,908	\$ (32,070)
Basic and Diluted Income (Loss) Per Share:			
Net loss from continuing operations	\$ (0.56)	\$ (0.36)	\$ (0.34)
Net income from discontinued operations	0.03	0.74	0.07
Net income (loss) per share	\$ (0.53)	\$ 0.38	\$ (0.27)
Shares used in computing basic and diluted income (loss) per share	122,352	121,476	120,845

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Year Ended December 31,		
	2007	2006	2005
	(In thousands)		
Net loss from continuing operations	\$ (68,105)	\$ (43,895)	\$ (40,904)
Other comprehensive income (loss), before taxes:			
Foreign currency translation adjustments	(24)	5	69
Holding losses on available-for-sale securities	(487)	(2,824)	(8,653)
Other comprehensive loss from continuing operations	(511)	(2,819)	(8,584)
Comprehensive loss from continuing operations	(68,616)	(46,714)	(49,488)
Income from discontinued operations	3,272	89,803	8,834
Other comprehensive income (loss) from discontinued operations		189	(36)
Comprehensive income (loss)	\$ (65,344)	\$ 43,278	\$ (40,690)

See Notes to Consolidated Financial Statements.

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SAFEGUARD SCIENTIFICS, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock		Additional	Accumulated Other Comprehensive		Treasury	Unamortized		Total
	Shares	Amount	Paid-In Capital	Deficit	Income (Loss)	Shares	Amount	Deferred Compensation	
	(In thousands)								
Balance December 31, 2004	119,893	\$ 11,989	\$ 745,991	\$ (565,018)	\$ 11,786	\$	\$	(3,518)	\$ 201,230
Net loss				(32,070)					(32,070)
Stock options exercised, net	42	4	48			(2)	9		61
Acceleration of vesting of restricted stock								279	279
Amortization of deferred compensation, net of forfeitures			(203)					1,371	1,168
Impact of subsidiary equity transactions			1,859					838	2,697
Issuance of restricted stock, net			113			4	(15)	(13)	85
Employee stock option expense			145						145
Other comprehensive loss					(8,620)				(8,620)
Balance December 31, 2005	119,935	11,993	747,953	(597,088)	3,166	2	(6)	(1,043)	164,975
Net income				45,908					45,908
Stock options exercised, net	236	25	346			(2)	6		377
Reclassification of unamortized deferred compensation			(1,043)					1,043	
Reclassification of redeemable subsidiary			(2,021)						(2,021)

stock-based compensation								
Impact of subsidiary equity transactions			(1,763)					(1,763)
Issuance of restricted stock, net	248	24	47					71
Stock-based compensation expense continuing and discontinued operations			6,842					6,842
Other comprehensive loss					(2,630)			(2,630)
Balance December 31, 2006	120,419	12,042	750,361	(551,180)	536			211,759
Net loss				(64,833)				(64,833)
Stock options exercised, net	492	49	692					741
Change in redeemable subsidiary stock-based compensation			937					937
Issuance of restricted stock, net	212	21	146					167
Stock-based compensation expense continuing and discontinued operations			6,379					6,379
Other comprehensive loss					(511)			(511)
Balance December 31, 2007	121,123	\$ 12,112	\$ 758,515	\$ (616,013)	\$ 25	\$	\$	\$ 154,639

See Notes to Consolidated Financial Statements.

Table of Contents**SAFEGUARD SCIENTIFICS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2007	2006	2005
	(In thousands)		
Cash Flows from Operating Activities:			
Net income (loss)	\$ (64,833)	\$ 45,908	\$ (32,070)
Adjustments to reconcile to net cash used in operating activities:			
Income from discontinued operations	(3,272)	(89,803)	(8,834)
Depreciation and amortization	10,666	9,816	6,440
Purchased in-process research and development			1,974
Deferred income taxes			304
Equity loss	14,143	3,267	6,597
Other (income) loss, net	4,866	(5,559)	(7,066)
Goodwill impairment	5,438		
Recovery related party		(360)	(28)
Non-cash stock-based compensation expense	6,603	6,637	2,034
Minority interest	(5,829)	(6,112)	(6,922)
Changes in assets and liabilities, net of effect of acquisitions and dispositions:			
Accounts receivable, net	(3,652)	2,296	(2,595)
Accounts payable, accrued expenses, deferred revenue and other	(1,092)	10,568	7,261
Cash flows from operating activities of discontinued operations	709	4,963	10,995
Net cash used in operating activities	(36,253)	(18,379)	(21,910)

Cash Flows from Investing Activities: