

SCM MICROSYSTEMS INC  
Form 10-Q  
May 17, 2010  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10 Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

OR

.. **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: 0-29440

**SCM MICROSYSTEMS, INC.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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**DELAWARE**  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)  
**1900 Carnegie Avenue, Building B**  
**Santa Ana, California 92705**

**77-0444317**  
(I.R.S. EMPLOYER  
IDENTIFICATION NUMBER)

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES INCLUDING ZIP CODE)

(949) 250-8888

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

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 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  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 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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

At May 13, 2010, 43,653,182 shares of common stock were outstanding, including 723,075 shares held in treasury.

**Table of Contents**

**TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. <u>Financial Statements</u>	3
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
Item 4. <u>Controls and Procedures</u>	33
<b>PART II. OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	33
Item 1A. <u>Risk Factors</u>	34
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	52
Item 3. <u>Defaults Upon Senior Securities</u>	52
Item 4. <u>Reserved</u>	52
Item 5. <u>Other Information</u>	52
Item 6. <u>Exhibits</u>	52
<u>SIGNATURES</u>	53
<u>EXHIBIT INDEX</u>	

**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1. Financial Statements****SCM MICROSYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)****(unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Net revenue	\$ 15,346	\$ 5,155
Cost of revenue	9,141	3,042
Gross profit	6,205	2,113
Operating expenses:		
Research and development	2,171	769
Selling and marketing	6,097	2,244
General and administrative	3,162	2,487
Restructuring and other charges	264	
Gain on sale of assets		(249)
Total operating expenses	11,694	5,251
Loss from operations	(5,489)	(3,138)
Loss on equity investments		(289)
Interest (expense) income, net	(231)	27
Foreign currency (losses) gains, net	(314)	252
Loss from continuing operations before income taxes and noncontrolling interest	(6,034)	(3,148)
(Provision) benefit for income taxes	(162)	1
Loss from continuing operations	(6,196)	(3,147)
(Loss) gain from discontinued operations, net of income taxes	(120)	67
Gain on sale of discontinued operations, net of income taxes	43	37
Consolidated net loss	(6,273)	(3,043)
Less: Net loss attributable to noncontrolling interest	221	
Net loss attributable to SCM Microsystems, Inc.	\$ (6,052)	\$ (3,043)
Basic and diluted net loss per share attributable to SCM Microsystems, Inc.:		
Loss from continuing operations	\$ (0.15)	\$ (0.20)
(Loss) income from discontinued operations	\$ 0.00	\$ 0.01

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Net loss per share	\$ (0.15)	\$ (0.19)
Weighted-average shares used to compute basic and diluted (loss) income per share	39,755	15,744

See notes to condensed consolidated financial statements.

**Table of Contents**

**SCM MICROSYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except par value)

(unaudited)

	March 31, 2010	December 31, 2009
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,753	\$ 4,836
Accounts receivable, net of allowances	9,005	6,739
Inventories, net	6,682	5,379
Income taxes receivable	271	274
Other current assets	2,948	1,647
Total current assets	25,659	18,875
Property and equipment, net	4,525	683
Goodwill	41,618	21,895
Intangible assets, net	34,344	22,082
Other assets	762	1,036
Total assets	\$ 106,908	\$ 64,571
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 8,807	\$ 5,530
Bank line of credit	220	
Liability to related party	1,359	1,027
Accrued compensation and related benefits	3,526	2,884
Mortgage loan payable to bank	57	
Other accrued expenses and liabilities	8,923	5,132
Income taxes payable	283	188
Total current liabilities	23,175	14,761
Long-term liability to related party	7,841	7,899
Mortgage loan payable to bank, long-term	896	
Deferred tax liability	4,480	3,515
Long-term income taxes payable	760	456
Total liabilities	37,152	26,631
Commitments and contingencies (see Notes 11 and 13)		
Equity:		
SCM Microsystems, Inc. Stockholders equity:		
Common stock, \$0.001 par value: 60,000 shares authorized; 41,053 and 25,753 shares issued outstanding as of March 31, 2010 and December 31, 2009, respectively	41	26
Additional paid-in capital	291,224	253,910
Treasury stock, 723 and 618 shares as of March 31, 2010 and December 31, 2009, respectively	(3,014)	(2,777)
Accumulated deficit	(222,430)	(216,378)
Other accumulated comprehensive income	1,299	3,159

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Total SCM Microsystems, Inc. stockholders' equity	67,120	37,940
Noncontrolling interest	2,636	
Total equity	69,756	37,940
Total liabilities and equity	\$ 106,908	\$ 64,571

See notes to condensed consolidated financial statements.

**Table of Contents****SCM MICROSYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF EQUITY AND COMPREHENSIVE LOSS****Year Ended December 31, 2009 and Three Months Ended March 31, 2010**

(In thousands)	Common Stock		SCM Microsystems, Inc. Shareholders			Other Accumulated Comprehensive Income (loss)	Noncontrolling Interest	Total Equity	Comprehensive Loss
	Shares	Amount	Paid-in Capital	Treasury Stock	Accumulated Deficit				
Balances, December 31, 2008	16,352	\$ 16	\$ 229,788	\$ (2,777)	\$ (202,199)	\$ 3,298	\$	\$ 28,126	
Issuance of common stock in connection with acquisition	9,391	10	23,775					23,785	
Stock-based compensation expense			347					347	
Comprehensive loss:									
Net loss					(14,179)			(14,179)	\$ (14,179)
Foreign currency translation adjustment						(139)		(139)	(139)
<b>Comprehensive loss</b>									<b>\$ (14,318)</b>
Balances, December 31, 2009	25,753	\$ 26	\$ 253,910	\$ (2,777)	\$ (216,378)	\$ 3,159	\$	\$ 37,940	
Issuance of common stock in connection with acquisition	15,300	15	34,562					34,577	
Issuance of stock options in connection with acquisition			3,007	(18,547)	\$ (22,253)	\$ (36,472)	\$ (44,978)	\$ (13,583)	\$ (16,369)

(1) We have not included a ratio of earnings to combined fixed charges and preferred stock dividends because we do not have any preferred stock outstanding.

**DESCRIPTION OF DEBT SECURITIES**

The debt securities covered by this prospectus will be our convertible senior or subordinated debt securities issued under one or more separate senior or subordinated indentures to be entered into between us and a trustee to be identified in the applicable prospectus supplement. This prospectus, together with its prospectus supplement, will describe all the material terms of a particular series of debt securities.

The following is a summary of the most important provisions and definitions of the indentures. For additional information, you should look at the applicable indenture that is filed as an exhibit to the registration statement which includes the prospectus. The indentures are substantially identical except for the subordination





**Table of Contents**

provisions described below under Subordinated Debt Securities. In this description of the debt securities, the words Nuvelo , we , us or our refer only to Nuvelo and not to any of our subsidiaries.

**General**

Debt securities may be issued in separate series without limitation as to aggregate principal amount. We may specify a maximum aggregate principal amount for the debt securities of any series.

We are not limited as to the amount of debt securities we may issue under the indentures. The prospectus supplement will set forth:

whether the debt securities will be senior or subordinated,

the offering price,

the title,

any limit on the aggregate principal amount,

the person who shall be entitled to receive interest, if other than the record holder on the record date,

the date the principal will be payable,

the interest rate, if any, the date interest will accrue, the interest payment dates and the regular record dates,

the place where payments may be made,

any mandatory or optional redemption provisions,

if applicable, the method for determining how the principal, premium, if any, or interest will be calculated by reference to an index or formula,

if other than U.S. currency, the currency or currency units in which principal, premium, if any, or interest will be payable and whether we or the holder may elect payment to be made in a different currency,

the portion of the principal amount that will be payable upon acceleration of stated maturity, if other than the entire principal amount,

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if the principal amount payable at stated maturity will not be determinable as of any date prior to stated maturity, the amount which will be deemed to be the principal amount,

any defeasance provisions if different from those described below under Satisfaction and Discharge; Defeasance,

any conversion or exchange provisions,

any obligation to redeem or purchase the debt securities pursuant to a sinking fund,

whether the debt securities will be issuable in the form of a global security,

any subordination provisions, if different from those described below under Subordinated Debt Securities,

**Table of Contents**

any deletions of, or changes or additions to, the events of default or covenants, and

any other specific terms of such debt securities.

Unless otherwise specified in the prospectus supplement:

the debt securities will be registered debt securities, and

registered debt securities denominated in U.S. dollars will be issued in denominations of \$1,000 or an integral multiple of \$1,000.

Debt securities may be sold at a substantial discount below their stated principal amount, bearing no interest or interest at a rate which at the time of issuance is below market rates.

**Exchange and Transfer**

Debt securities may be transferred or exchanged at the office of the security registrar or at the office of any transfer agent designated by us.

We will not impose a service charge for any transfer or exchange, but we may require holders to pay any tax or other governmental charges associated with any transfer or exchange.

In the event of any potential redemption of debt securities of any series, we will not be required to:

issue, register the transfer of, or exchange, any debt security of that series during a period beginning at the opening of business 15 days before the day of mailing of a notice of redemption and ending at the close of business on the day of the mailing, or

register the transfer of or exchange any debt security of that series selected for redemption, in whole or in part, except the unredeemed portion being redeemed in part.

We may initially appoint the trustee as the security registrar. Any transfer agent, in addition to the security registrar, initially designated by us will be named in the prospectus supplement. We may designate additional transfer agents or change transfer agents or change the office of the transfer agent. However, we will be required to maintain a transfer agent in each place of payment for the debt securities of each series.

**Global Securities**

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The debt securities of any series may be represented, in whole or in part, by one or more global securities. Each global security will:

be registered in the name of a depositary that we will identify in a prospectus supplement,

be deposited with the depositary or nominee or custodian, and

bear any required legends.

No global security may be exchanged in whole or in part for debt securities registered in the name of any person other than the depositary or any nominee unless:

the depositary has notified us that it is unwilling or unable to continue as depositary or has ceased to be qualified to act as depositary,

an event of default is continuing, or

## **Table of Contents**

any other circumstances described in a prospectus supplement.

As long as the depository, or its nominee, is the registered owner of a global security, the depository or nominee will be considered the sole owner and holder of the debt securities represented by the global security for all purposes under the indenture. Except in the above limited circumstances, owners of beneficial interests in a global security:

will not be entitled to have the debt securities registered in their names,

will not be entitled to physical delivery of certificated debt securities, and

will not be considered to be holders of those debt securities under the indentures.

Payments on a global security will be made to the depository or its nominee as the holder of the global security. Some jurisdictions have laws that require that certain purchasers of securities take physical delivery of such securities in definitive form. These laws may impair the ability to transfer beneficial interests in a global security.

Institutions that have accounts with the depository or its nominee are referred to as participants. Ownership of beneficial interests in a global security will be limited to participants and to persons that may hold beneficial interests through participants. The depository will credit, on its book-entry registration and transfer system, the respective principal amounts of debt securities represented by the global security to the accounts of its participants.

Ownership of beneficial interests in a global security will be shown on and effected through records maintained by the depository, with respect to participants' interests, or any participant, with respect to interests of persons held by participants on their behalf.

Payments, transfers and exchanges relating to beneficial interests in a global security will be subject to policies and procedures of the depository.

The depository policies and procedures may change from time to time. Neither we nor the trustee will have any responsibility or liability for the depository's or any participant's records with respect to beneficial interests in a global security.

## **Payment and Paying Agent**

The provisions of this paragraph will apply to the debt securities unless otherwise indicated in the prospectus supplement. Payment of interest on a debt security on any interest payment date will be made to the person in whose name the debt security is registered at the close of business on the regular record date. Payment on debt securities of a particular series will be payable at the office of a paying agent or paying agents designated by us. However, at our option, we may pay interest by mailing a check to the record holder. The corporate trust office will be designated as our sole paying agent.

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We may also name any other paying agents in the prospectus supplement. We may designate additional paying agents, change paying agents or change the office of any paying agent. However, we will be required to maintain a paying agent in each place of payment for the debt securities of a particular series.

All moneys paid by us to a paying agent for payment on any debt security which remain unclaimed at the end of two years after such payment was due will be repaid to us. Thereafter, the holder may look only to us for such payment.

**Table of Contents**

**Consolidation, Merger and Sale of Assets**

We may not consolidate with or merge into any other person, in a transaction in which we are not the surviving corporation, or convey, transfer or lease our properties and assets substantially as an entirety to, any person, unless:

the successor, if any, is a U.S. corporation, limited liability company, partnership, trust or other entity,

the successor assumes our obligations on the debt securities and under the indenture,

immediately after giving effect to the transaction, no default or event of default shall have occurred and be continuing, and

certain other conditions are met.

**Events of Default**

Unless we inform you otherwise in the prospectus supplement, the indenture will define an event of default with respect to any series of debt securities as one or more of the following events:

- (1) failure to pay principal of or any premium on any debt security of that series when due,
- (2) failure to pay any interest on any debt security of that series for 30 days when due,
- (3) failure to deposit any sinking fund payment when due,
- (4) failure to perform any other covenant in the indenture continued for 60 days after being given the notice required in the indenture,
- (5) our bankruptcy, insolvency or reorganization, and
- (6) any other event of default specified in the prospectus supplement.



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An event of default of one series of debt securities is not necessarily an event of default for any other series of debt securities.

If an event of default, other than an event of default described in clause (5) above, shall occur and be continuing, either the trustee or the holders of at least 25% in aggregate principal amount of the outstanding securities of that series may declare the principal amount of the debt securities of that series to be due and payable immediately.

If an event of default described in clause (5) above shall occur, the principal amount of all the debt securities of that series will automatically become immediately due and payable. Any payment by us on the subordinated debt securities following any such acceleration will be subject to the subordination provisions described below under Subordinated Debt Securities.

After acceleration the holders of a majority in aggregate principal amount of the outstanding securities of that series may, under certain circumstances, rescind and annul such acceleration if all events of default, other than the non-payment of accelerated principal, or other specified amount, have been cured or waived.

Other than the duty to act with the required care during an event of default, the trustee will not be obligated to exercise any of its rights or powers at the request of the holders unless the holders shall have offered to the trustee reasonable indemnity. Generally, the holders of a majority in aggregate principal amount of the outstanding debt securities of any series will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the trustee or exercising any trust or power conferred on the trustee.

## **Table of Contents**

A holder will not have any right to institute any proceeding under the indentures, or for the appointment of a receiver or a trustee, or for any other remedy under the indentures, unless:

(1) the holder has previously given to the trustee written notice of a continuing event of default with respect to the debt securities of that series,

(2) the holders of at least 25% in aggregate principal amount of the outstanding debt securities of that series have made a written request and have offered reasonable indemnity to the trustee to institute the proceeding, and

(3) the trustee has failed to institute the proceeding and has not received direction inconsistent with the original request from the holders of a majority in aggregate principal amount of the outstanding debt securities of that series within 60 days after the original request.

Holders may, however, sue to enforce the payment of principal, premium or interest on any debt security on or after the due date or to enforce the right, if any, to convert any debt security without following the procedures listed in (1) through (3) above.

We will furnish the trustee an annual statement by our officers as to whether or not we are in default in the performance of the indenture and, if so, specifying all known defaults.

## **Modification and Waiver**

Nuvelo and the trustee may make modifications and amendments to the indentures with the consent of the holders of a majority in aggregate principal amount of the outstanding securities of each series affected by the modification or amendment.

However, neither we nor the trustee may make any modification or amendment without the consent of the holder of each outstanding security of that series affected by the modification or amendment if such modification or amendment would:

change the stated maturity of any debt security,

reduce the principal, premium, if any, or interest on any debt security,

reduce the principal of an original issue discount security or any other debt security payable on acceleration of maturity,

reduce the rate of interest on any debt security,

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change the currency in which any debt security is payable,

impair the right to enforce any payment after the stated maturity or redemption date,

waive any default or event of default in payment of the principal of, premium or interest on any debt security,

waive a redemption payment or modify any of the redemption provisions of any debt security,

adversely affect the right to convert any debt security, or

change the provisions in the indenture that relate to modifying or amending the indenture.

## **Table of Contents**

### **Satisfaction and Discharge; Defeasance**

We may be discharged from our obligations on the debt securities of any series that have matured or will mature or be redeemed within one year if we deposit with the trustee enough cash to pay all the principal, interest and any premium due to the stated maturity date or redemption date of the debt securities.

Each indenture contains a provision that permits us to elect:

to be discharged from all of our obligations, subject to limited exceptions, with respect to any series of debt securities then outstanding, and/or

to be released from our obligations under the following covenants and from the consequences of an event of default resulting from a breach of these covenants:

- (1) the subordination provisions under the subordinated indenture, and
- (2) covenants as to payment of taxes and maintenance of corporate existence.

To make either of the above elections, we must deposit in trust with the trustee enough money to pay in full the principal, interest and premium on the debt securities. This amount may be made in cash and/or U.S. government obligations. As a condition to either of the above elections, we must deliver to the trustee an opinion of counsel that the holders of the debt securities will not recognize income, gain or loss for Federal income tax purposes as a result of the action.

If any of the above events occurs, the holders of the debt securities of the series will not be entitled to the benefits of the indenture, except for the rights of holders to receive payments on debt securities or the registration of transfer and exchange of debt securities and replacement of lost, stolen or mutilated debt securities.

### **Notices**

Notices to holders will be given by mail to the addresses of the holders in the security register.

### **Governing Law**

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The indentures and the debt securities will be governed by, and construed under, the law of the State of New York.

### **Regarding the Trustee**

The indenture limits the right of the trustee, should it become a creditor of us, to obtain payment of claims or secure its claims.

The trustee is permitted to engage in certain other transactions. However, if the trustee, acquires any conflicting interest, and there is a default under the debt securities of any series for which they are trustee, the trustee must eliminate the conflict or resign.

### **Subordinated Debt Securities**

Payment on the subordinated debt securities will, to the extent provided in the indenture, be subordinated in right of payment to the prior payment in full of all of our senior indebtedness. The subordinated debt securities also are effectively subordinated to all debt and other liabilities, including trade payables and lease obligations, if any, of our subsidiaries.

Upon any distribution of our assets upon any dissolution, winding up, liquidation or reorganization, the payment of the principal of and interest on the subordinated debt securities will be subordinated in right of payment to the prior payment in full in cash or other payment satisfactory to the holders of senior indebtedness of

## Table of Contents

all senior indebtedness. In the event of any acceleration of the subordinated debt securities because of an event of default, the holders of any senior indebtedness would be entitled to payment in full in cash or other payment satisfactory to such holders of all senior indebtedness obligations before the holders of the subordinated debt securities are entitled to receive any payment or distribution. The indenture requires us or the trustee to promptly notify holders of designated senior indebtedness if payment of the subordinated debt securities is accelerated because of an event of default.

We may not make any payment on the subordinated debt securities, including upon redemption at the option of the holder of any subordinated debt securities or at our option, if:

a default in the payment of the principal, premium, if any, interest, rent or other obligations in respect of designated senior indebtedness occurs and is continuing beyond any applicable period of grace (called a "payment default"); or

a default other than a payment default on any designated senior indebtedness occurs and is continuing that permits holders of designated senior indebtedness to accelerate its maturity, and the trustee receives a notice of such default (called a "payment blockage notice") from us or any other person permitted to give such notice under the indenture (called a "non-payment default").

We may resume payments and distributions on the subordinated debt securities:

in the case of a payment default, upon the date on which such default is cured or waived or ceases to exist; and

in the case of a non-payment default, the earlier of the date on which such nonpayment default is cured or waived or ceases to exist and 179 days after the date on which the payment blockage notice is received by the trustee, if the maturity of the designated senior indebtedness has not been accelerated.

No new period of payment blockage may be commenced pursuant to a payment blockage notice unless 365 days have elapsed since the initial effectiveness of the immediately prior payment blockage notice and all scheduled payments of principal, premium and interest, including any liquidated damages, on the notes that have come due have been paid in full in cash. No non-payment default that existed or was continuing on the date of delivery of any payment blockage notice shall be the basis for any later payment blockage notice unless the non-payment default is based upon facts or events arising after the date of delivery of such payment blockage notice.

If the trustee or any holder of the notes receives any payment or distribution of our assets in contravention of the subordination provisions on the subordinated debt securities before all senior indebtedness is paid in full in cash, property or securities, including by way of set-off, or other payment satisfactory to holders of senior indebtedness, then such payment or distribution will be held in trust for the benefit of holders of senior indebtedness or their representatives to the extent necessary to make payment in full in cash or payment satisfactory to the holders of senior indebtedness of all unpaid senior indebtedness.

In the event of our bankruptcy, dissolution or reorganization, holders of senior indebtedness may receive more, ratably, and holders of the subordinated debt securities may receive less, ratably, than our other creditors (including our trade creditors). This subordination will not prevent the occurrence of any event of default under the indenture.

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As of March 31, 2003, \$9.2 million senior indebtedness was outstanding. We are not prohibited from incurring debt, including senior indebtedness, under the indenture. We may from time to time incur additional debt, including senior indebtedness.

We are obligated to pay reasonable compensation to the trustee and to indemnify the trustee against certain losses, liabilities or expenses incurred by the trustee in connection with its duties relating to the subordinated debt securities. The trustee's claims for these payments will generally be senior to those of noteholders in respect of all funds collected or held by the trustee.

## **Table of Contents**

### **Certain Definitions**

indebtedness means:

- (1) all indebtedness, obligations and other liabilities for borrowed money, including overdrafts, foreign exchange contracts, currency exchange agreements, interest rate protection agreements, and any loans or advances from banks, or evidenced by bonds, debentures, notes or similar instruments, other than any account payable or other accrued current liability or obligation incurred in the ordinary course of business in connection with the obtaining of materials or services;
- (2) all reimbursement obligations and other liabilities with respect to letters of credit, bank guarantees or bankers' acceptances;
- (3) all obligations and liabilities in respect of leases required in conformity with generally accepted accounting principles to be accounted for as capitalized lease obligations on our balance sheet;
- (4) all obligations and other liabilities under any lease or related document in connection with the lease of real property which provides that we are contractually obligated to purchase or cause a third party to purchase the leased property and thereby guarantee a minimum residual value of the leased property to the lessor and our obligations under the lease or related document to purchase or to cause a third party to purchase the leased property;
- (5) all obligations with respect to an interest rate or other swap, cap or collar agreement or other similar instrument or agreement or foreign currency hedge, exchange, purchase agreement or other similar instrument or agreement;
- (6) all direct or indirect guaranties or similar agreements in respect of, and our obligations or liabilities to purchase, acquire or otherwise assure a creditor against loss in respect of, indebtedness, obligations or liabilities of others of the type described in (1) through (5) above;
- (7) any indebtedness or other obligations described in (1) through (6) above secured by any mortgage, pledge, lien or other encumbrance existing on property which is owned or held by us; and
- (8) any and all refinancings, replacements, deferrals, renewals, extensions and refundings of, or amendments, modifications or supplements to, any indebtedness, obligation or liability of the kind described in clauses (1) through (7) above.

senior indebtedness means the principal, premium, if any, interest, including any interest accruing after bankruptcy, and rent or termination payment on or other amounts due on our current or future indebtedness, whether created, incurred, assumed, guaranteed or in effect guaranteed by us, including any deferrals, renewals, extensions, refundings, amendments, modifications or supplements to the above. However, senior indebtedness does not include:



indebtedness that expressly provides that it shall not be senior in right of payment to the subordinated debt securities or expressly provides that it is on the same basis or junior to the subordinated debt securities;

our indebtedness to any of our majority-owned subsidiaries; and

the subordinated debt securities.

#### **DESCRIPTION OF PREFERRED STOCK**

We currently have authorized 8,000,000 shares of preferred stock, of which 3,000,000 shares have been designated Series A Preferred Stock, 100,000 shares have been designated Series B Junior Participating Preferred Stock, and 4,900,000 shares are undesignated preferred stock. As of July 8, 2003, we do not have any shares of preferred stock outstanding.

## Table of Contents

### General

Prior to issuance of shares of each series of our undesignated preferred stock, our Board of Directors is required by the Nevada Revised Statutes, or NRS, and our Amended and Restated Articles of Incorporation, or articles of incorporation, to adopt resolutions and file a Certificate of Designation with the Secretary of State of the State of Nevada, fixing for each such series the designations, voting powers, preferences, limitations, restrictions and relative rights of the shares of such series. Our Board of Directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of discouraging a takeover or other transaction which holders of some, or a majority, of such shares might believe to be in their best interests or in which holders of some, or a majority, of such shares might receive a premium for their shares over the then-market price of such shares.

Subject to limitations prescribed by the NRS, our articles of incorporation and our Amended and Restated Bylaws, or bylaws, our Board of Directors is authorized to fix the number of shares constituting each series of preferred stock and the designations, voting powers, preferences, limitations, restrictions and relative rights of the shares of such series, including such provisions as may be desired concerning voting, redemption, dividends, dissolution or the distribution of assets, conversion or exchange, and such other subjects or matters as may be fixed by resolution of the Board of Directors. Each series of preferred stock that we offer under this prospectus will, when issued, be fully paid and nonassessable and will not have, or be subject to, any preemptive or similar rights.

The applicable prospectus supplement(s) will describe the following terms of the series of preferred stock in respect of which this prospectus is being delivered:

the title and stated value of the preferred stock;

the number of shares of the preferred stock offered, the liquidation preference per share and the purchase price of the preferred stock;

the dividend rate(s), period(s) and/or payment date(s) or the method(s) of calculation for dividends;

whether dividends shall be cumulative or non-cumulative and, if cumulative, the date from which dividends on the preferred stock shall accumulate;

the procedures for any auction and remarketing, if any, for the preferred stock;

the provisions for a sinking fund, if any, for the preferred stock;

the provisions for redemption, if applicable, of the preferred stock;

any listing of the preferred stock on any securities exchange or market;

the terms and conditions, if applicable, upon which the preferred stock will be convertible into common stock or another series of our preferred stock, including the conversion price (or its manner of calculation) and conversion period;

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the terms and conditions, if applicable, upon which preferred stock will be exchangeable into our debt securities, including the exchange price (or its manner of calculation) and exchange period;

voting rights, if any, of the preferred stock;

a discussion of any material and/or special United States federal income tax considerations applicable to the preferred stock;

whether interests in the preferred stock will be represented by depositary shares;

the relative ranking and preferences of the preferred stock as to dividend rights and rights upon liquidation, dissolution or winding up of our affairs;

## **Table of Contents**

any limitations on issuance of any series of preferred stock ranking senior to or on a parity with the preferred stock as to dividend rights and rights upon liquidation, dissolution or winding up of our affairs; and

any other specific terms, preferences, rights, limitations or restrictions on the preferred stock.

Unless otherwise specified in the prospectus supplement, the preferred stock will, with respect to dividend rights and rights upon liquidation, dissolution or winding up of Nuvelo rank:

senior to all classes or series of our common stock, and to all equity securities issued by us the terms of which specifically provide that such equity securities rank junior to the preferred stock with respect to dividend rights or rights upon the liquidation, dissolution or winding up of us;

on a parity with all equity securities issued by us that do not rank senior or junior to the preferred stock with respect to dividend rights or rights upon the liquidation, dissolution or winding up of us; and

junior to all equity securities issued by us the terms of which do not specifically provide that such equity securities rank on a parity with or junior to the preferred stock with respect to dividend rights or rights upon the liquidation, dissolution or winding up of us (including any entity with which we may be merged or consolidated or to which all or substantially all of our assets may be transferred or which transfers all or substantially all of our assets).

As used for these purposes, the term "equity securities" does not include convertible debt securities.

## **Transfer Agent and Registrar**

The transfer agent and registrar for any series of preferred stock will be set forth in the applicable prospectus supplement.

## **DESCRIPTION OF COMMON STOCK**

The following is only a summary of the material terms of our common stock or our stockholder rights agreement. Because it is only a summary, it does not contain all the information that may be important to you. Accordingly, you should read carefully the more detailed provisions of our articles of incorporation, bylaws and rights agreement, each of which has been filed with the SEC, as well as applicable Nevada law.

We currently have authorized 100,000,000 shares of common stock and, as of June 30, 2003, we had 63,667,334 shares of common stock outstanding. As of June 30, 2003, we had an aggregate of 7,239,379 shares of common stock reserved for issuance upon exercise of outstanding stock options granted under our 2002 Equity Incentive Plan, 1995 Stock Option Plan, Non-Employee Director Stock Option Plan, Scientific Advisory Board/ Consultants Stock Option Plan and the Variagenics, Inc. Amended 1997 Employee, Director and Consultant Stock Option Plan, and an aggregate of 4,298,980 shares of common stock reserved for issuance pursuant to future option grants under these plans. As of June 30, 2003, we had an aggregate of 2,443,160 shares of common stock reserved for issuance upon the exercise of stock options granted outside of any of our stock option plans. As of June 30, 2003, we had warrants to purchase an aggregate of 6,389,718 shares of our common stock outstanding,

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with exercise prices ranging from \$1.35 to \$8.51 per share, and a weighted average exercise price of \$5.49 per share.

### **Common Stock**

Holders of our common stock are entitled to one vote per share for the election of directors and all other matters submitted for stockholder vote, except matters submitted to the vote of another class or series of shares. Holders of common stock are not entitled to cumulative voting rights. The approval of 66<sup>2</sup>/<sub>3</sub>% of the voting rights of the common stock is required to make certain amendments to our articles of incorporation, amend our

## **Table of Contents**

by-laws, and to remove a director from our board of directors. The affirmative vote of the holders of a majority of the outstanding shares of our common stock is required to approve the sale by us of U.S. Patent 5,202,231, or the exclusive license or assignment by us of U.S. Patent 5,202,231 to a single person or entity having the same effect as a sale of all rights, title and interest in it.

The holders of common stock are entitled to dividends in such amounts and at such times, if any, as may be declared by our board of directors out of legally available funds. We have not paid any dividends on our common stock and do not anticipate paying any cash dividends on our common stock in the foreseeable future. Upon liquidation, dissolution or winding up of us, the holders of our common stock are entitled to share ratably in all net assets available for distribution to stockholders after payments to creditors and holders of senior securities. The common stock is not redeemable and has no preemptive, conversion or sinking fund rights. The rights of the holders of our common stock are subject to the rights of the holders of any preferred stock which may, in the future, be issued. All outstanding shares of our common stock are, and any shares of common stock issued pursuant to this prospectus when issued will be, duly authorized, validly issued, fully paid and non-assessable.

As of June 30, 2003, 63,667,334 shares of our common stock were issued and outstanding.

## **Transfer Agent**

The transfer agent and registrar for our common stock is U.S. Stock Transfer Corporation. Its offices are located at 1745 Gardena Ave., Glendale, California 91204, and its telephone number is (818) 502-1404.

## **Stockholder Rights Agreement**

On June 5, 1998, our board of directors adopted a stockholder rights agreement, or rights agreement. Pursuant to the rights agreement, one whole right attaches to each outstanding share of our common stock. Each right entitles the registered holder to purchase from us one one-thousandth (1/1000) of a share of our Series B Junior Participating Preferred Stock at an initial purchase price of \$175.00, subject to customary antidilution adjustments. The rights do not become exercisable until the earlier to occur of:

10 business days following a public announcement that a person or group has acquired beneficial ownership of 15% (or 27.5% in the case of an approved stockholder) or more of our outstanding common stock (any such person or group is referred to as an acquiring person), or

10 business days (or a later date as determined by our board of directors) following the commencement or announcement of an intention to make a tender offer or exchange offer, that would result in a person or entity becoming an acquiring person

The rights will expire on June 5, 2008, unless they are redeemed or exchanged by Hyseq before that time. Until a right is exercised, the rights do not convey the right to vote, receive dividends or others provide the holder with any rights as a stockholder.

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When a person or group becomes an acquiring person (or at such later time as determined by independent directors of our board of directors) then each registered holder of a right, except for such person or group, will be entitled to purchase, for the purchase price, shares of our common stock having a then current market value equal to two times the purchase price of the right. Subject to specified exemptions, in the event that we are involved in a merger, or we sells more than 50% of our assets or earning power to an acquiring company, each right will entitle the holder, other than an acquiring person, to purchase, upon exercise, a number of shares of common stock of the acquiring company having a then current market value of two times the purchase price of the right.

We may, at our option, at any time prior to the close of business on the tenth day following the day a person or group becomes an acquiring person, redeem all of the then-outstanding rights at a redemption price of \$.001 per right, subject to certain adjustments. At any time after a person or group becomes an acquiring person and

## **Table of Contents**

prior to the acquisition by that person or group of 50% or more of the outstanding shares of our common stock, our board of directors may cause us to acquire the rights (other than rights owned by the acquiring person), in whole or in part, in exchange for one share of common stock per right.

While the rights are redeemable, we may supplement or amend any provision of the rights agreement in any respect without the approval of any holders of rights or share of common stock. When the rights are no longer redeemable, we may supplement or amend the rights agreement without the approval of any holders of rights certificates as long as the supplement or amendment does not adversely affect the interests of the holders of rights (other than an acquiring person). Any supplement or amendment to the rights agreement shall require the affirmative vote of a majority of our independent directors. Any extension of the final expiration date of the rights shall require the affirmative vote of three-quarters of the independent directors.

## **ADDITIONAL INFORMATION CONCERNING OUR CAPITAL STOCK**

### **Anti-Takeover Effects of Our Articles of Association and Bylaws**

Our articles of incorporation and by-laws include a number of provisions that may have the effect of encouraging persons considering unsolicited tender offers or other unilateral takeover proposals to negotiate with our board of directors rather than pursue non-negotiated takeover attempts. These provisions include:

that members of our board of directors serve staggered terms of up to three years;

that the holders of 66<sup>2</sup>/<sub>3</sub>% of the voting rights of all classes of stock entitled to vote are required to remove our directors;

that the board of directors may fill vacancies on the board of directors;

that all stockholder action must be effected at a duly called meeting and not by a consent in writing;

that our stockholders may call a special meeting of stockholders only upon a request of stockholders owning not less than 50% of our outstanding shares of common stock;

that stockholders must comply with certain notice requirements to nominate directors to serve on our board of directors and to bring proposals before annual and special meetings of stockholders;

that the board of directors is authorized to designate the rights and privileges of our authorized and unissued preferred stock; and

that the holders of 66<sup>2</sup>/<sub>3</sub>% of the voting rights of all classes of stock entitled to vote are required to amend the by-laws and certain provisions of our articles of incorporation.



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These provisions could discourage, delay or prevent certain types of transactions involving an actual or potential change in control of us, including transactions in which stockholders might otherwise receive a premium for their shares over current market prices.

### **Business Combination Statute under Nevada Law**

We are also subject to provisions of Nevada law that could discourage, delay or prevent an actual or potential change in control of us. Nevada law prohibits certain business combinations between a corporation and an interested stockholder for three years after the stockholder became an interested stockholder unless the stockholder, prior to becoming an interested stockholder, obtained the approval of the board of directors of either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder.

Nevada law will permit, however, business combinations that meet all requirements of the corporation's articles of incorporation and either:

are approved by the board of directors before the stockholder became an interested stockholder (or as to which the purchase of shares made by the interested stockholder had been approved by the board of directors before the date of purchase),

## **Table of Contents**

are approved by the affirmative vote of the holders of stock representing a majority of the voting stock (excluding voting stock of the interested stockholder and its affiliates and associates) at a meeting called for such purpose no earlier than three years after the stockholder became an interested stockholder, or

the form and amount of consideration to be received by stockholders (excluding the interested stockholder) of the corporation satisfies certain tests and, with limited exceptions, the interested stockholder has not become the beneficial owner of additional voting shares of the corporation after becoming an interested stockholder and before the business combination is consummated.

An interested stockholder means, generally stated, a stockholder who, directly or indirectly, beneficially owns 10% or more of the outstanding voting stock of a corporation.

A corporation may expressly exclude itself from application of the foregoing business combination provisions of Nevada law, but we have not done so.

## **Limitation of Liability and Indemnification**

In accordance with Nevada law, our articles of incorporation provide that none of our officers or directors shall be personally liable to us or any of our stockholders for damages for breach of fiduciary duty as an officer or director. However, this provision excludes any limitation on liability for (1) acts or omissions which involve intentional misconduct, fraud or a knowing violation of law, or (2) the payment of distributions in violation of Nevada law.

In accordance with Nevada law, our by-laws provide that we shall indemnify any person who was or is a party or is threatened to be made a party to, or otherwise becomes involved in, any proceeding (other than an action by or in the right of Nuvelo) by reason of the fact that he is or was an officer, director or agent of Nuvelo against losses actually and reasonably incurred by that person if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to our best interests. Losses are the total amount that the officer, director or agent becomes legally obligated to pay, including judgments, fines, amounts paid in settlement, attorneys' fees, expenses of establishing a right to indemnification and other expenses. If the proceeding is a criminal proceeding, the person to be indemnified must have had no reasonable cause to believe his or her conduct was unlawful.

Our bylaws provide for similar indemnification for expenses resulting from an action by or in the right of Nuvelo, except that no indemnification will be made if the person is adjudged by a court of competent jurisdiction after exhaustion of all appeals to be liable to us or for amounts paid in settlement to us unless the court determines that the person is fairly and reasonably entitled to indemnity for expenses. Expenses of officers, directors and agents include attorneys' fees, any expenses of establishing a right to indemnification and amounts paid in settlement. Our bylaws also provide for advancement of expenses.

We also maintain liability insurance for our officers and directors, and have entered into indemnification agreements with them.

## **PLAN OF DISTRIBUTION**

We may sell the securities separately or together:

through one or more underwriters or dealers in a public offering and sale by them,

directly to investors, or

through agents.

**Table of Contents**

We may sell the securities from time to time in one or more transactions at a fixed price or prices, which may be changed from time to time:

at market prices prevailing at the times of sale,

at prices related to such prevailing market prices, or

at negotiated prices.

We will describe the method of distribution of the securities in the prospectus supplement.

Underwriters, dealers or agents may receive compensation in the form of discounts, concessions or commissions from us or our purchasers (as their agents in connection with the sale of securities). These underwriters, dealers or agents may be considered to be underwriters under the Securities Act. As a result, discounts, commissions, or profits on resale received by the underwriters, dealers or agents may be treated as underwriting discounts and commissions. The prospectus supplement will identify any such underwriter, dealer or agent, and describe any compensation received by them from us. Any initial public offering price and any discounts or concessions allowed or reallocated or paid to dealers may be changed from time to time.

Underwriters, dealers and agents may be entitled to indemnification by us against certain civil liabilities, including liabilities under the Securities Act, or to contribution with respect to payments made by the underwriters, dealers or agents, under agreements between us and the underwriters, dealers and agents.

We may grant underwriters who participate in the distribution of securities an option to purchase additional securities to cover over-allotments, if any, in connection with the distribution.

All debt securities will be new issues of securities with no established trading market. Underwriters involved in the public offering and sale of debt securities may make a market in the debt securities. However, they are not obligated to make a market and may discontinue market making activity at any time. No assurance can be given as to the liquidity of the trading market for any debt securities.

Underwriters or agents and their associates may be customers of, engage in transactions with or perform services for us in the ordinary course of business.

**LEGAL MATTERS**

The validity of the securities being offered by this prospectus will be passed upon for us by Kummer Kaempfer Bonner & Renshaw or Las Vegas, Nevada.

**EXPERTS**

The consolidated financial statements of Nuvelo, Inc. as of December 31, 2002 and 2001 and for each of the years in the three year period ended December 31, 2002 have been incorporated by reference herein and in the registration statement in reliance upon the report of KPMG LLP, independent auditors, incorporated by reference herein, and upon the authority of said firm as experts in accounting and auditing.

The consolidated financial statements of Variagenics, Inc. as of December 31, 2002 and 2001, and for each of the three years in the period ended December 31, 2002 incorporated in this prospectus by reference to the Current Report on Form 8-K/A, dated July 3, 2003 of Nuvelo, Inc., have been so incorporated in reliance on the reports of PricewaterhouseCoopers LLP, independent accountants, given the authority of said firm as experts in auditing and accounting.

**Table of Contents**

**WHERE YOU CAN FIND MORE INFORMATION**

We are a reporting company and file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission, or the SEC. You may read and copy these reports, proxy statements and other information at the SEC's public reference rooms at 450 Fifth Street, N.W., Washington, D.C., 20549, as well as at the SEC's regional office at 500 West Madison Street, Suite 1400, Chicago, Illinois, 60661. You can request copies of these documents by writing to the SEC and paying a fee for the copying cost. Please call the SEC at 1-800-SEC-0330 for more information about the operation of the public reference rooms. Our SEC filings are also available at the SEC's Web site at <http://www.sec.gov>. In addition, you can read and copy our SEC filings at the office of the National Association of Securities Dealers, Inc. at 1735 K Street, Washington, D.C. 20006.

The SEC allows us to incorporate by reference information that we file with them, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is an important part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information. Further, all filings we make under the Securities Exchange Act after the date of the initial registration statement and prior to effectiveness of the registration statement shall be deemed to be incorporated by reference into this prospectus. We incorporate by reference the documents listed below and any future filings we will make with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934:

our annual report on Form 10-K for the fiscal year ended December 31, 2002, filed with the SEC on March 31, 2003, as amended on Form 10-K/A filed with the SEC on April 30, 2003;

our quarterly report on Form 10-Q for the quarter ended March 31, 2003, filed with the SEC on May 14, 2003;

our current report on Form 8-K, filed with the SEC on January 21, 2003;

our current report on Form 8-K, filed with the SEC on January 28, 2003;

our current report on Form 8-K, filed with the SEC on February 4, 2003, as amended on Form 8-K/A filed with the SEC on February 14, 2003, and as further amended on Form 8-K/A filed with the SEC on July 3, 2003; and

the description of our common stock set forth in our Registration Statement on Form 8-A, filed with the SEC on July 23, 1997.

We will provide to you at no cost a copy of any and all of the information incorporated by reference into the registration statement of which this prospectus is a part. You may make a request for copies of this information in writing or by telephone. Requests should be directed to:

**Nuvelo, Inc.**

**Attention: Peter S. Garcia**

**675 Almanor Avenue**

**Sunnyvale, CA 94085**



**Table of Contents**