Pendrell Corp
Form 10-Q
November 01, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

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 001-33008

PENDRELL CORPORATION

(Exact name of registrant as specified in its charter)

Washington	**98-0221142**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**

2300 Carillon Point, Kirkland, Washington 98033

(Address of principal executive offices including zip code)

(425) 278-7100

(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 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 x 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 x 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.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 x.

As of October 25, 2013, the registrant had 212,384,662 shares of Class A common stock and 53,660,000 shares of Class B convertible common stock outstanding.

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PENDRELL CORPORATION

FORM 10-Q

For the three and nine months ended September 30, 2013

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Pendrell Corporation

Condensed Consolidated Balance Sheets

(In thousands, except share data, unaudited)

	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 191,028	$ 213,753
Accounts receivable, net of allowance for doubtful accounts of $0 in both periods	493	8,471
Other receivables net of reserve $2,750 in both periods	68	856
Prepaid expenses and other current assets	1,739	689
Total current assets	193,328	223,769
Property in service net of accumulated depreciation of $722 and $464, respectively	3,851	946
Other assets	75	67
Intangible assets net of accumulated amortization of $27,212 and $15,456, respectively	143,747	135,424
Goodwill	21,725	21,209
Total	$ 362,726	$ 381,415
LIABILITIES, STOCKHOLDERS EQUITY AND NONCONTROLLING INTERESTS		
Current liabilities:		
Accounts payable	$ 524	$ 285
Accrued expenses	6,223	2,382
Other liabilities	2,600	647
Total current liabilities	9,347	3,314
Deferred tax liability	1,488	1,488
Other non-current liabilities	4,957	753
Total liabilities	15,792	5,555
Commitments and contingencies (Note 7)		
Stockholders equity and noncontrolling interests:		

Preferred stock, $0.01 par value, 75,000,000 shares authorized, no shares issued or outstanding		
Class A common stock, $0.01 par value, 900,000,000 shares authorized, 270,086,095 and 269,450,966 shares issued, 212,317,203 and 211,682,074 shares outstanding	2,124	2,118
Class B convertible common stock, $0.01 par value, 150,000,000 shares authorized, 84,663,382 shares issued and 53,660,000 shares outstanding	537	537
Additional paid-in capital	1,938,875	1,929,526
Accumulated deficit	(1,607,347)	(1,563,999)
Total Pendrell stockholders equity	334,189	368,182
Noncontrolling interests	12,745	7,678
Total stockholders equity and noncontrolling interests	346,934	375,860
Total	$ 362,726	$ 381,415

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Pendrell Corporation

Condensed Consolidated Statements of Operations

(In thousands, except share and per share data, unaudited)

	Three months ended September 30, 2013	Three months ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
Revenue	$ 781	$ 1,023	$ 12,575	$ 25,515
Operating expenses:				
Patent administration, litigation and related costs	1,912	1,360	13,860	4,769
General and administrative	6,933	7,109	21,738	22,464
Stock-based compensation	2,883	1,768	10,001	4,848
Amortization of intangible assets	4,090	3,589	11,805	9,882
Total operating expenses	15,818	13,826	57,404	41,963
Operating income (loss)	(15,037)	(12,803)	(44,829)	(16,448)
Interest income	24	58	104	178
Interest expense	(63)		(129)	(2,483)
Gain on deconsolidation of subsidiaries				48,685
Gain on settlement of Boeing litigation				10,000
Gain (loss) associated with disposition of assets		(4)		5,599
Other income (expense)	5	220	(40)	1,584
Income (loss) before income taxes	(15,071)	(12,529)	(44,894)	47,115
Income tax benefit				1,004
Net income (loss)	(15,071)	(12,529)	(44,894)	48,119
Net loss attributable to noncontrolling interests	(843)	(380)	(2,478)	(68)
Net income (loss) attributable to Pendrell	$ (14,228)	$ (12,149)	$ (42,416)	$ 48,187
Basic income (loss) per share attributable to Pendrell	$ (0.05)	$ (0.05)	$ (0.16)	$ 0.19
Diluted income (loss) per share attributable to Pendrell	$ (0.05)	$ (0.05)	$ (0.16)	$ 0.18
Weighted average shares outstanding used to compute basic income (loss)	263,089,771	256,741,845	261,680,596	256,486,019

per share				
Weighted average shares outstanding used to compute diluted income (loss) per share	263,089,771	256,741,845	261,680,596	263,772,311

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Pendrell Corporation

Condensed Consolidated Statements of Comprehensive Income (Loss)

(In thousands, unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2013	**2012**	**2013**	**2012**
Net income (loss)	$ (15,071)	$ (12,529)	$ (44,894)	$ 48,119
Other comprehensive income (loss):				
Cumulative translation adjustments				(1,019)
Reclassification of cumulative translation adjustment loss included in net income				12,679
Comprehensive income (loss)	(15,071)	(12,529)	(44,894)	59,779
Comprehensive loss attributable to noncontrolling interests	843	380	2,478	68
Comprehensive income (loss) attributable to Pendrell	$ (14,228)	$ (12,149)	$ (42,416)	$ 59,847

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Pendrell Corporation

Condensed Consolidated Statements Changes in Stockholders Equity

(In thousands, except share data, unaudited)

	Common stock					Accumulated other comprehensive				
	Class A shares	Class B shares	Amount	Additional paid-in capital	Treasury stock	income (loss)	Accumulated deficit	Stockholders equity	Noncontrolling interests	To
ce, nber 31,	206,696,021	53,660,000	$ 3,497	$ 2,794,970	$ (877,833)	$ (11,660)	$ (1,603,941)	$ 305,033	$ 7,745	$ 312
g of A on stock for an ition				1,892				1,892		1
ce of A on stock xercise k options arrants	590,375		6	734				740		
A on stock eld at g to cover ory tax tions	(88,056)		(1)		(219)			(220)		
based ensation suance of ted stock, ures	(315,382)		15	4,601	6			4,622		4
ehensive e						11,660		11,660		11
come							48,187	48,187	(68)	48
ce, nber 30,	206,882,958	53,660,000	$ 3,517	$ 2,802,197	$ (878,046)	$	$ (1,555,754)	$ 371,914	$ 7,677	$ 379

ce, nber 31,	211,682,074	53,660,000	$ 2,655	$ 1,929,526	$	$	$ (1,563,999)	$ 368,182	$ 7,678	$ 375
g of A on stock for an ition				1,148				1,148		1
ce of A on stock xercise k options arrants	98,750		1	104				105		
A on stock eld at g to cover ry tax tions	(567,728)		(6)	(1,722)			(932)	(2,660)		(2
based ensation suance of ted stock, ures	1,104,107		11	9,819				9,830		9
ntrolling t in ro									7,545	7
ss							(42,416)	(42,416)	(2,478)	(44
ce, nber 30,	212,317,203	53,660,000	$ 2,661	$ 1,938,875	$	$	$ (1,607,347)	$ 334,189	$ 12,745	$ 346

The accompanying notes are an integral part of these condensed consolidated financial statements

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Pendrell Corporation

Condensed Consolidated Statements of Cash Flows

(In thousands, unaudited)

	Nine months ended September 30, 2013	Nine months ended September 30, 2012
Operating activities:		
Net income (loss) including noncontrolling interests	$ (44,894)	$ 48,119
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Stock-based compensation	10,001	4,848
Amortization of prepaid compensation from Ovidian Group acquisition	2,073	2,261
Amortization of intangibles	11,805	9,882
Depreciation	339	152
Unrealized foreign exchange gains	(8)	(442)
Non-cash cost of patents monetized	252	
Gain on deconsolidation of subsidiaries		(48,685)
Gain associated with disposition of assets		(5,599)
Other	176	
Other changes in certain assets and liabilities, net of acquisitions:		
Accounts receivable	8,037	(9,551)
Other receivables	788	248
Prepaid expenses and other current/non-current assets	(125)	(365)
Accounts payable	(51)	674
Accrued interest payable		1,704
Other accrued liabilities	2,935	(6,144)
Net cash used in operating activities	(8,672)	(2,898)
Investing activities:		
Purchases of property and intangible assets	(2,294)	(29,372)
Proceeds associated with disposition of assets		15,647
Acquisition of Provitro, net of cash acquired	(9,204)	
Net cash used in investing activities	(11,498)	(13,725)
Financing activities:		
Proceeds from exercise of stock options	105	740
Payment of statutory taxes for stock awards	(2,660)	(220)
Net cash provided by (used in) financing activities	(2,555)	520
Effect of foreign exchange rate changes on cash		725

Net decrease in cash and cash equivalents	(22,725)	(15,378)
Cash and cash equivalents beginning of period	213,753	230,377
Cash and cash equivalents end of period	$ 191,028	$ 214,999
Supplemental disclosures:		
Income taxes paid	$	$ 2,156
Income taxes received	745	
Supplemental disclosures of non-cash investing and financing activities:		
Accrued obligations for purchases of property and intangible assets	5,573	

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Pendrell Corporation

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Nature of Business

These condensed consolidated financial statements include the accounts of Pendrell Corporation (Pendrell) and its consolidated subsidiaries (collectively referred to as the Company). The Company, through its consolidated subsidiaries, invests in, acquires and develops businesses with unique technologies that are often protected by intellectual property (IP) rights, and that present the opportunity to address large, global markets. The Company s subsidiaries focus on licensing the IP rights they hold to third parties and pursuing relevant product opportunities. The Company continuously evaluates its existing investments to determine whether retention or disposition is appropriate, and frequently investigates new investment and business acquisition opportunities. The Company also advises its clients on various IP strategies and transactions through its IP advisory subsidiary.

2. Basis of Presentation

Interim Financial Statements The financial information included in the accompanying condensed consolidated financial statements is unaudited and includes all adjustments, consisting of normal recurring adjustments and accruals, considered necessary for a fair presentation in accordance with accounting principles generally accepted in the United States of America (GAAP). Certain information and footnote disclosures have been condensed or omitted. The financial information as of December 31, 2012 is derived from the Company s audited consolidated financial statements and notes included in Item 8 in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (2012 Form 10-K), filed with the U.S. Securities and Exchange Commission on March 8, 2013. The financial information included in this quarterly report should be read in conjunction with management s discussion and analysis of financial condition and results of operations and the consolidated financial statements and notes included in the 2012 Form 10-K. Operating results and cash flows for the interim periods presented are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2013 or any other interim period.

Principles of Consolidation The consolidated financial statements of the Company include the assets and liabilities of its wholly-owned subsidiaries and subsidiaries it controls or in which it has a controlling financial interest. Noncontrolling interests on the consolidated balance sheets include third-party investments in entities that the Company consolidates, but does not wholly own. Noncontrolling interests are classified as part of equity and the Company allocates net income (loss), other comprehensive income (loss) and other equity transactions to its noncontrolling interests in accordance with their applicable ownership percentages. All intercompany transactions and balances have been eliminated in consolidation. All information in these financial statements is in U.S. dollars.

Use of Estimates The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates.

On an ongoing basis, the Company evaluates its estimates, including among others, those related to the fair value of acquired intangible assets and goodwill, the useful lives and potential impairment of intangible assets and property and equipment, the value of stock awards for the purpose of determining stock-based compensation expense, accrued liabilities, valuation allowances related to the ability to realize deferred tax assets, allowances for doubtful receivables and certain tax liabilities. Estimates are based on historical experience and other factors, including the current economic environment as deemed appropriate under the circumstances. Estimates and assumptions are adjusted when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Any changes in estimates used to prepare these financial statements will be reflected in the financial statements in future periods.

Reclassifications Certain prior period amounts have been reclassified to conform to current year presentation. The reclassifications had no effect on previously reported net income (loss).

Updates to Accounting Policies Except as outlined below, there have been no material changes or updates in the Company s existing accounting policies from the disclosures included in its 2012 Form 10-K.

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Revenue Recognition The Company derives its operating revenue from IP monetization activities, including patent licensing and patent sales, and from IP consulting services.

The Company s patent licensing agreements typically provide for the payment of contractually determined upfront license fees representing all or a majority of the revenue that will be generated from such agreements for nonexclusive, nontransferable, limited duration licenses. These agreements typically grant (i) a non-exclusive license to make, sell, distribute, and use certain specified products that read on the Company s patents, (ii) a covenant not to enforce patent rights against the licensee based on such activities, and (iii) the release of the licensee from certain claims.

The Company sells patents from its portfolios from time to time. These sales are part of the Company s ongoing operations. Consequently, the related proceeds are recorded as revenue. The Company recognizes the revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) amounts are fixed or determinable, and (iv) collectability is reasonably assured.

Fees earned from IP consulting services are generally recognized as the services are performed.

The timing and amount of revenue recognized from IP monetization activities depend on the specific terms of each agreement and the nature of the deliverables and obligations. Agreements that are deemed to contain multiple elements are accounted for under ASC 605-20, *Revenue Recognition Multiple Element Arrangements*. This guidance requires consideration to be allocated to each element of an agreement that has stand-alone value using the relative fair value method. The Company recognizes revenue when (i) persuasive evidence of an arrangement exists, (ii) all material obligations have been substantially performed pursuant to agreement terms or services have been rendered to the customer, (iii) amounts are fixed or determinable, and (iv) collectability is reasonably assured. As a result of the contractual terms of the Company s patent monetization agreements and the unpredictable nature, form and frequency of monetizing transactions, the Company s revenue may fluctuate substantially from period to period.

Patent administration, litigation and related costs Patent administration, litigation and related costs are comprised of patent-related maintenance, prosecution, and enforcement costs incurred to maintain the Company s patents. In periods where there is licensing revenue, these costs include costs associated with generating such licensing revenue. Similarly, in periods where patent sales occur, these costs include the remaining net book value and other related costs associated with the sold patents.

Research and Development The Company incurs costs associated with research and development activities and expenses the costs in the period incurred. Research and development expenses during the period were immaterial and are included in general and administrative expenses.

New Accounting Pronouncements In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2013-11, *Income Taxes (Topic 740) Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (Update No 2013-11). Update No. 2013-11 requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, with certain exceptions. Update No. 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, with early adoption permitted. Update No. 2013-11 can be applied prospectively to all unrecognized tax benefits with retrospective application permitted. The retroactive adoption of this statement on January 1, 2013, did not have a material impact on the Company s financial position, results of operations or cash flows.

In February 2013, the FASB issued Update No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* (Update No. 2013-02). Update No. 2013-02 amended existing guidance by requiring additional disclosure either on the face of the income statement or in the notes to the financial statements of significant amounts reclassified out of accumulated other comprehensive income. Update No. 2013-02 is effective for reporting periods beginning after December 15, 2012. The adoption of this statement on January 1, 2013, did not have a material impact on the Company s financial position, results of operations or cash flows.

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3. Business Combinations

On February 21, 2013, the Company acquired a 68.75% interest in Provitro Biosciences LLC (Provitro). Accordingly, the activities of Provitro from the acquisition date though September 30, 2013, have been included in the Company s condensed consolidated statement of operations for the three and nine months ended September 30, 2013. Acquisition-related costs, including advisory, legal, accounting, valuation and other costs associated with the acquisition of Provitro of $0.4 million, are included in general and administrative expenses. The Company is continuing to develop the Provitro technology and formulating its strategy for commercialization.

The following table summarizes the allocation of the $16.6 million cash paid to the assets acquired and liabilities assumed on February 21, 2013 (in thousands):

Tangible assets acquired and liabilities assumed:	
Cash	$ 7,396
Other current and noncurrent assets, net of liabilities	430
Property in service	2,950
Net tangible assets acquired	10,776
Identifiable intangible assets	12,853
Goodwill	516
Fair value of assets acquired	24,145
Fair value of 31.25% noncontrolling interest	(7,545)
Total purchase price	$ 16,600

These allocations were based on fair value estimates as of the closing date of the acquisition and are included in the Company s consolidated balance sheet at September 30, 2013. The Company used the cost approach to value the $12.9 million of definite-lived intangible assets related to the developed Provitro technology. The Company has determined that the expected period of benefit of the developed technology is approximately ten years. Future adjustments may modify the purchase accounting during the measurement period which is not to exceed one year from the acquisition date.

The acquisition of Provitro is not material to the Company s results of operations or cash flows.

4. Asset Acquisitions and Divestitures

The Company has used, and may continue to use, different structures and forms of consideration for its acquisitions. Acquisitions may be consummated through the use of cash, equity, seller financing, third party debt, earn-out obligations, revenue sharing, profit sharing, or some combination of these types of consideration. Consequently, the acquisition values reflected in the Company s investing activities may represent lower amounts than would be reflected, for example, in a situation where cash alone was utilized to complete the acquisition.

During the nine months ended September 30, 2013, the Company expanded its patent holdings through the acquisition of additional patents covering memory and storage technologies for electronic devices. During 2012, the Company acquired patent portfolios covering wireless handset and infrastructure technologies, e-commerce, mobile applications, video delivery, security, and other technologies.

During the nine months ended September 30, 2013, the Company sold patents in several transactions and has included the gross proceeds in revenue. Cost associated with the patents sold, including any remaining net book value, are included in patent administration, litigation and related costs. Certain of the patents sold were subject to an obligation to pay a substantial portion of the net proceeds to a third party. In future periods, these third party payments as a percentage of revenues may vary significantly based on the structure utilized for any given acquisition.

The net effect of the patent acquisitions and divestures, including the issuance of more than twenty additional patents since the beginning of 2013, resulted in the Company, through its subsidiaries, holding more than 1,600 issued patents worldwide, with additional patent applications pending.

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Prior to 2011, the Company was in the business of developing and operating a next generation global mobile satellite communications system, including the research and development of various wireless technologies. In 2011, the Company began divesting its satellite assets, and during the three months ended March 31, 2012, the Company received the final payment associated with the 2011 sale of its interests in DBSD North America, Inc. and its subsidiaries to DISH Network Corporation. Additionally, during the three months ended March 31, 2012, the Company (i) completed the sale of its real property in Brazil for $5.6 million, (ii) sold its medium earth orbit (MEO) satellite assets (MEO Assets) that had been in storage for nominal consideration and (iii) transferred its in-orbit MEO satellite (F2) to a new operator who assumed responsibility for all F2 operating costs effective April 1, 2012. On June 29, 2012, the Company transferred its MEO-related international subsidiaries (International Subsidiaries) to a liquidating trust (the Liquidating Trust). All of the property in Brazil, the MEO Assets and substantially all of the assets of the International Subsidiaries had been written off in prior years.

5. Accrued expenses

The following table summarizes accrued expenses (in thousands):

	September 30, 2013	December 31, 2012
Accrued payroll and related expenses	$ 3,657	$ 1,092
Accrued legal, professional and other expenses	2,566	1,290
	$ 6,223	$ 2,382

6. Other liabilities

From time to time the Company agrees to make contingent and non-contingent future payments in connection with acquisition transactions. The Company recognizes the contingent portion of these future payments as liabilities when they are estimable and it is probable that they will be paid. Other liabilities, both current and noncurrent, that meet these criteria include installment payment obligations at September 30, 2013, arising from property and intangible asset acquisitions of which $2.0 million is due in 2014 and $4.0 million is due in 2015. There were no future payment obligations at December 31, 2012.

7. Commitments and Contingencies

Purchase and Lease Commitments The Company s contractual obligations include installment payment obligations arising from property and intangible asset acquisitions. Additionally, the Company has operating lease agreements for its main office in Kirkland, Washington, and offices in California, Texas, Washington, DC and Finland.

Litigation In the opinion of management, except for those matters described below and elsewhere in this report, to the extent so described, litigation, contingent liabilities and claims against the Company in the normal course of business are not expected to involve any judgments or settlements that would be material to the Company s financial condition, results of operations or cash flows.

ZTE Enforcement Actions On February 27, 2012, ContentGuard Holdings, Inc. (ContentGuard), a subsidiary of Pendrell, filed a patent infringement lawsuit against ZTE Corporation and ZTE (USA) Inc. (collectively ZTE) in the Eastern District of Virginia, in which ContentGuard alleged that the defendants have infringed and continue to infringe six of its patents by making, using, selling or offering for sale certain mobile communication and computing devices. The case was transferred to the federal court in the Southern District of California on May 18, 2012. ContentGuard requested a jury trial and is seeking injunctive relief, damages and pre-judgment and post-judgment interest. On February 12, 2013, ZTE filed petitions for inter partes review (IPR) of the six asserted patents with the United States Patent and Trademark Office and moved to stay the action in the Southern District of California. ZTE filed IPR petitions on all six patents in suit, challenging the validity of 290 out of 310 claims. Subsequently, the Patent Trial and Appeal Board (PTAB) concluded that there was no merit to ZTE's assertions of invalidity on 103 claims. The inter partes review proceedings have been dismissed in their entirety with respect to one patent. The PTAB has scheduled hearings on the remaining five patents in February and March 2014. The Company cannot anticipate the outcome of either the lawsuit or the United States Patent and Trademark Office review, including possible appeals.

On November 19, 2012, ContentGuard s subsidiary, ContentGuard Europe GmbH, filed a patent infringement lawsuit against ZTE Corporation and ZTE Deutschland GmbH in Mannheim Regional Court in Germany, in which ContentGuard Europe GmbH alleged that the defendants have infringed and continue to infringe three of its patents by making, using, selling or offering for sale certain mobile communication and computing devices. An initial hearing on one of the patents was held in May 2013, with a follow up hearing scheduled for November 2013. Hearings on the other two patents are scheduled for January 2014. The Company cannot anticipate the timing or outcome of these suits.

J&J Arbitration In March 2012, the Company asserted claims in arbitration in London against Jay and Jayendra (Pty) (J&J Group) to recover approximately $2.7 million in costs that J&J Group was required to reimburse the Company pursuant to a MEO satellite asset purchase agreement that was signed in April 2011. In May 2012, J&J Group counterclaimed for breach of contract, seeking approximately $1.2 million, plus attorney fees and costs. The arbitration was held in September 2012, and judgment was awarded in November 2012, in favor of the Company. J&J Group submitted multiple appeals to the UK courts, the last of which was rejected in July 2013. The Company has commenced a collection action in South Africa (where J&J Group is domiciled), but due to the uncertainty of collection, the Company has not recognized the gain associated with the judgment.

8. Stock-based Compensation

The Company records stock-based compensation on stock options, stock appreciation rights, performance stock awards, performance cash awards, restricted stock awards, restricted stock unit awards and other stock awards based on the estimated fair value on the date of grant and recognizes compensation cost over the requisite service period for awards expected to vest.

The fair value of stock options and stock appreciation rights is estimated on the date of grant using the Black-Scholes option pricing model (Black-Scholes Model) based on the single option award approach. The fair value of restricted stock awards and restricted stock units is determined based on the number of shares granted and either the quoted market price of the Company s Class A common stock on the date of grant for service-based and performance-based awards, or the fair value on the date of grant using the Monte Carlo Simulation model (Monte Carlo Simulation) for market-based awards. The fair value of stock options, restricted stock awards and restricted stock units with service conditions are amortized to expense on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. The fair value of stock appreciation rights, restricted stock awards and restricted stock units with performance conditions deemed probable of being achieved is amortized to expense over the requisite service period using the straight-line method of expense recognition. The fair value of restricted stock awards and restricted stock units with performance and market conditions are amortized to expense over the requisite service period using the straight-line method of expense recognition.

Stock-based compensation expense included in the condensed consolidated statements of operations for the three and nine months ended September 30, 2013 and 2012 was as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Stock options	$ 1,352	$ 1,117	$ 4,313	$ 3,091
Restricted stock awards (1)	1,531	651	5,688	1,757
Total stock-based compensation expense	$ 2,883	$ 1,768	$ 10,001	$ 4,848

(1) Stock-based compensation expense for the three and nine months ended September 30, 2013, includes $0.2 million and $0.6 million of expense, respectively, related to 250,000 Class A common stock restricted stock awards that are required to be treated as a liability. Stock-based compensation expense for the three and nine

months ended September 30, 2012, includes $0.2 million and $0.4 million, respectively, arising from such awards. As of September 30, 2013, and December 31, 2012, $1.2 million and $0.6 million, respectively, were accrued for such awards.

Stock Options and Stock Appreciation Rights The Company has granted stock options and stock appreciation rights (SARs) to employees, directors, consultants and/or advisors in connection with their service to the Company.

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The Company s stock option and SARs activity for the nine months ended September 30, 2013 is summarized as follows:

	Number of shares of Class A common stock underlying options and SARs	Weighted average exercise price
Outstanding December 31, 2012	28,485,375	$ 2.19
Granted (1)	1,142,000	$ 1.55
Exercised	(98,750)	$ 1.08
Forfeited	(1,449,689)	$ 2.21
Outstanding September 30, 2013	28,078,936	$ 2.17
Exercisable September 30, 2013	10,391,831	$ 2.10
Vested and expected to vest September 30, 2013	27,305,460	$ 2.19

(1) The stock options granted during the nine months ended September 30, 2013 have a grant date fair value of $1.0 million and vest at a rate of 25% per year over four years.

Restricted Stock The Company has granted restricted stock awards to employees and consultants in connection with their service to the Company. The Company s stock grants can be categorized as either service-based awards, performance-based awards, and/or market-based awards.

The Company s restricted stock activity for the nine months ended September 30, 2013 is summarized as follows:

	Number of shares of Class A common stock underlying restricted stock awards	Weighted average fair value per share
Unvested December 31, 2012	9,808,375	$ 1.84
Granted	792,489	$ 1.35
Vested	(4,228,280)	$ 1.53
Forfeited	(442,342)	$ 1.79
Unvested September 30, 2013	5,930,242	$ 1.62

Restricted stock granted during the nine months ended September 30, 2013 consists of the following:

	Number of shares of Class A common stock underlying restricted stock awards granted	Grant date fair value (in thousands)
Service-based	211,250	$ 327
Market-based	300,000	285
Shares issued as Board of Director compensation	281,239	455
Total restricted stock granted	792,489	$ 1,067

The service-based restricted stock awards vest at a rate of 25% per year over four years. The market-based restricted stock awards consist of two awards of 150,000 units each which vest only after designated time periods have elapsed and designated stock prices (each a Price Threshold) have been met. Specifically, for each 150,000 stock award, (i) 25% vests when at least one year has passed and the Price Threshold has been met, (ii) 25% vests when at least two years have passed and the Price Threshold has been met, (iii) 25% vests when at least three years have passed and the Price Threshold has been met, and (iv) the final 25% vests when at least four years have passed and the Price Threshold has been met. The Price Threshold for one of the 150,000 stock awards is an average closing price of $3.00 for 20 consecutive trading days. The Price Threshold for the other 150,000 stock award is an average closing price of $6.00 for 20 consecutive trading days.

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During the nine months ended September 30, 2013, 2,780,164 market-based restricted stock awards vested as a result of the Company s achievement of the market condition of an average closing stock price of $2.00 for 60 consecutive calendar days and 1,448,116 service-based restricted shares vested as a result of the achievement of service targets. Certain holders of the vested restricted stock awards exercised their right to have their awards net-share settled to cover statutory employee taxes related to the vesting of the restricted stock awards. The settlement of these awards resulted in the Company repurchasing and/or cancelling 1,107,901 shares for $2.7 million. Of this amount, $1.0 million was charged to retained earnings and $1.7 million was charged to additional paid in capital.

9. Deconsolidation of Subsidiaries

After the sale of the MEO Assets during the first quarter of 2012, the Company s only remaining satellite-related assets were owned by the International Subsidiaries. The Company determined that the most expeditious method of divesting the MEO Assets was a complete disposition of the International Subsidiaries into the Liquidating Trust.

As a result of the transfer of the International Subsidiaries to the Liquidating Trust, the Company no longer has control or significant influence over the operating decisions of the International Subsidiaries. Accordingly, due to the Company s loss of control, it deconsolidated the International Subsidiaries from its consolidated financial operating results effective June 29, 2012.

As a result of the deconsolidation of the International Subsidiaries, the Company recognized a gain of $48.7 million principally through the elimination of $61.9 million of liabilities associated with the International Subsidiaries, including liabilities for uncertain tax positions, net of the recognition of cumulative translation adjustment losses associated with the International Subsidiaries of $12.7 million previously recognized in accumulated other comprehensive loss in stockholders equity. The following table summarizes the obligations of the International Subsidiaries, excluding $10.0 million for liabilities related to uncertain tax positions, prior to the transfer to the Liquidating Trust on June 29, 2012 (in thousands):

	June 29, 2012	December 31, 2011
Accrued expenses	$ 6,568	$ 6,519
Accrued interest	30,474	28,092
Capital lease obligations	14,881	14,896
	$ 51,923	$ 49,507

The Company continued to accrue expenses associated with contractual obligations of the International Subsidiaries until the liabilities were transferred to the Liquidating Trust. During the nine months ended September 30, 2012, the Company recorded general and administrative expenses related to the International Subsidiaries of $0.3 million. Additionally, the Company recorded $2.5 million of interest expense related to the contractual obligations of the International Subsidiaries during the nine months ended September 30, 2012.

10. Gain on settlement of Boeing Litigation

The Company was in litigation with The Boeing Company, arising out of agreements with Boeing for the development and launch of its MEO satellites and related launch vehicles. In February 2009, the trial court entered judgment in the Company s favor for approximately $603.2 million.

On April 13, 2012, the California Court of Appeal overturned the judgment. The reversal was the culmination of a three year Court of Appeal process. The Court of Appeal also ordered the Company to reimburse Boeing for its appellate costs, including the cost of an appellate bond, which would have been material.

On June 25, 2012, the Company settled its litigation against Boeing. As part of the settlement, the Company agreed to withdraw its petition for review to the California Supreme Court in exchange for a $10.0 million payment from Boeing and Boeing s waiver of its right to appellate costs. The settlement agreement and mutual release between the Company and Boeing fully releases and discharges any and all claims between Boeing and the Company. As a result of the settlement agreement, the Company recorded a gain on litigation settlement of $10.0 million during the three and nine months ended September 30, 2012.

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11. Income Taxes

The Company anticipates it will not have a tax liability for fiscal 2013 and, therefore, has recorded no tax expense for the three and nine months ended September 30, 2013. The Company recorded no tax expense for the three months ended September 30, 2012 and an income tax benefit of $1.0 million for the nine months ended September 30, 2012, primarily related to the expiration of the statute of limitations applicable to previously recorded uncertain tax positions related to the International Subsidiaries, including interest and penalties. The associated liabilities for uncertain tax positions were eliminated as part of the deconsolidation of the International Subsidiaries on June 29, 2012.

The disposal of the Company s satellite assets generated net operating losses (NOLs) of approximately $2.4 billion, which the Company believes can be carried forward to offset taxable income for up to 20 years, subject to IRS loss recognition provisions. At September 30, 2013, $2.1 billion of NOLs were immediately available and begin to expire in 2025 and $0.3 billion were related to the International Subsidiaries and will not be available until five years following the disposition of the International Subsidiaries by the Liquidating Trust.

Certain Taxes Payable Irrespective of NOLs - Under the Internal Revenue Code and related Treasury Regulations, the Company may carry forward its NOLs in certain circumstances to offset current and future income and thus reduce its federal income tax liability, subject to certain restrictions. To the extent that the NOLs do not otherwise become limited, the Company believes that it will be able to carry forward a significant amount of NOLs. However, these NOLs will not impact all taxes to which the Company may be subject. For instance, state or foreign income taxes and/or revenue based taxes may be payable if the Company s income or revenue is attributed to jurisdictions that impose such taxes; the Company s NOLs do not entirely offset its income for alternative minimum tax; and Pendrell or one or more of its corporate subsidiaries may incur federal personal holding company tax liability. This is not an exhaustive list, but merely illustrative of the types of taxes to which its NOLs are not applicable.

Personal Holding Company Determination A personal holding company is a corporation with five individual shareholders whose ownership exceeds 50% of the corporation s outstanding shares, measured by share value (Concentrated Ownership), and which generates personal holding company income (which includes most royalty revenue and other types of passive revenues) that constitutes 60% or more of its adjusted ordinary gross income. For a corporate subsidiary, Concentrated Ownership is determined by reference to ownership of the parent corporation(s), and the subsidiary s income is subject to additional tests to determine whether the income renders the subsidiary a personal holding company. Due to the realization of subsidiary-level income, Pendrell s consolidated subsidiary ContentGuard may be a personal holding company. The Company does not anticipate any resulting personal holding company tax liability for current or prior years because if it is determined that ContentGuard is a personal holding company, ContentGuard may pay a dividend to its shareholders (including the Company which is a 90.1% shareholder), rather than incur personal holding company tax. Following a personal holding company determination (if such a determination occurs), if future personal holding company revenues at ContentGuard result in net personal holding company income, and if ContentGuard does not distribute to its shareholders a proportionate dividend in the amount of such income, then the net personal holding company income will be taxed (at 20% under current law).

Tax Benefits Preservation Plan Effective January 29, 2010, the Board of Directors adopted the Tax Benefits Preservation Plan to help the Company preserve its ability to utilize fully its NOLs, to preserve potential future NOLs, and to thereby reduce potential future federal income tax obligations. If the Company experiences an ownership change, as defined in Section 382 of the Internal Revenue Code, the Company s ability to use the NOLs could be significantly limited.

The Tax Benefits Plan is intended to act as a deterrent to any person or group acquiring, without the approval of the Company s Board of Directors, beneficial ownership of 4.9% or more of the Company s securities, defined to include:

(i) shares of its Class A common stock and Class B common stock, (ii) shares of its preferred stock, (iii) warrants, rights, or options to purchase its securities, and (iv) any interest that would be treated as stock of the Company for purposes of Section 382 or pursuant to Treasury Regulation § 1.382-2T(f)(18).

Holders of 4.9% or more of the Company s securities outstanding as of the close of business on January 29, 2010 will not trigger the Tax Benefits Plan so long as they do not (i) acquire additional securities constituting one-half of one percent (0.5%) or more of the Company s securities outstanding as of the date of the Tax Benefits Plan (as adjusted to reflect any stock splits, subdivisions and the like), or (ii) fall under 4.9% ownership of the Company s securities and then re-acquire securities that increase their ownership to 4.9% or more of the Company s securities. The Board of Directors may exempt certain persons whose acquisition of securities is determined by the Board of Directors not to jeopardize the Company s tax benefits or to otherwise be in the best interest of the Company and its shareholders. The Board of Directors may also exempt certain transactions.

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12. Income (Loss) per Share

Income (Loss) Per Share Basic income (loss) per share is calculated based on the weighted average number of Class A common stock and Class B common stock (the Common Shares) outstanding during the period. Diluted income (loss) per share is calculated by dividing the income (loss) allocable to common shareholders by the weighted average Common Shares outstanding plus dilutive potential Common Shares. Prior to the satisfaction of vesting conditions, unvested restricted stock awards are considered contingently issuable and are excluded from weighted average Common Shares outstanding used for computation of basic income (loss) per share.

Potential dilutive Common Shares consist of the incremental Class A common stock issuable upon the exercise of outstanding stock options (both vested and non-vested), stock appreciation rights, warrants, and unvested restricted stock awards and units, calculated using the treasury stock method. The calculation of dilutive shares outstanding excludes out-of-the-money stock options (i.e., such options exercise prices were greater than the average market price of the Company s Class A common shares for the period) because their inclusion would have been antidilutive.

The following table sets forth the computation of basic and diluted income (loss) per share (in thousands, except share and per share data):

	Three months ended September 30,		Nine months ended September 30,	
	2013	**2012**	**2013**	**2012**
Net income (loss) attributable to Pendrell	$ (14,228)	$ (12,149)	$ (42,416)	$ 48,187
Weighted average common shares outstanding	265,809,024	260,935,935	265,533,351	260,829,278
Less: weighted average unvested restricted stock awards	(2,719,253)	(4,194,090)	(3,872,755)	(4,343,259)
Shares used for computation of basic income (loss) per share	263,089,771	256,741,845	261,680,596	256,486,019
Add back: weighted average unvested restricted stock awards and units				5,805,979
Add back: dilutive stock options and stock appreciation rights				1,480,313
Shares used for computation of diluted income (loss) per share(1)	263,089,771	256,741,845	261,680,596	263,772,311
Basic income (loss) per share attributable to Pendrell	$ (0.05)	$ (0.05)	$ (0.16)	$ 0.19

Diluted income (loss) per share attributable to Pendrell	$	(0.05)	$	(0.05)	$	(0.16)	$	0.18