APACHE CORP
Form 4
May 26, 2015

FORM 4

OMB APPROVAL

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
HARRIS MARGERY M

(Last) (First) (Middle)

2000 POST OAK BLVD., SUITE 100

(Street)

HOUSTON, TX 77056

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
APACHE CORP [APA]

3. Date of Earliest Transaction (Month/Day/Year)
05/26/2015

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Exec. Vice President

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	05/26/2015		M		1,220	A	$ 0	16,423	D	
Common Stock	05/26/2015		F(1)		512	D	$ 62.53	15,911	D	
Common Stock								2,553.679	I	Held by Trustee of 401(k) Plan
Common Stock								5,939.458	I	Held by Trustee of NQ Plan

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Pr Deriv Secu (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Restricted Stock / Units (2)	$ 0 (3)	05/26/2015		M			1,220	(4)	(4)	Common Stock	1,220	$

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
HARRIS MARGERY M 2000 POST OAK BLVD. SUITE 100 HOUSTON, TX 77056			Exec. Vice President	

Signatures

Cheri L. Peper, Attorney-in-Fact	05/26/2015
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Shares withheld to cover required tax withholding on vesting of restricted stock effective as of 05/22/2015. Data provided by plan administrator on 05/26/2015.

(2) With tandem tax withholding right

(3) One share of Apache common stock for each restricted stock unit.

(4)

Vesting on 05/22/2015 of restricted stock units under employer plan - vesting occurs 25% per year over four years. Data provided by plan administrator on 05/26/2015.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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Net cash provided by (used in) investing activities	(5,385)	(1,430)	563	(757)	(505)
Net cash provided by (used in) financing activities	998	(1,967)	(3,247)	(4,033)	(1,533)

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Quarterly Financial Data:

The following table sets forth a summary of our quarterly financial data for the fiscal years ended December 31, 2010 and December 31, 2009. This information has been derived from our unaudited condensed consolidated financial statements and has been prepared on the same basis as our audited consolidated financial statements contained in this report. It includes all adjustments, consisting only of normal recurring adjustments that we consider necessary for a fair presentation of such information when read in conjunction with our audited financial statements and related notes. Operating results for any quarter are not necessarily indicative of results for any future period. This information should be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes included elsewhere in this report.

Selected Quarterly Financial Information (Unaudited):

	Quarters Ended			
	March 31, 2010	June 30, 2010	Sept. 30, 2010	Dec. 31, 2010
	(in thousands, except per share amounts)			
Net revenues	$10,481	$11,790	$12,198	$10,548
Cost of revenues	5,768	5,891	6,890	6,413
Gross profit	4,713	5,899	5,308	4,135
Income (loss) before provision for (benefit from) income taxes	1,346	2,900	2,005	(132)
Net income	1,337	3,007	948	4,505
Net loss attributable to noncontrolling interests	-	30	122	182
Net income attributable to Southwall	1,337	3,037	1,070	4,687
Deemed dividend on preferred stock	122	122	122	123
Net income attributable to common stockholders	$1,215	$2,915	$948	$4,564
Net income per share (1):				
Basic	$0.21	$0.51	$0.16	$0.79
Diluted	$0.19	$0.42	$0.15	$0.63
Weighted average shares used in computing net income per share (1):				
Basic	5,758	5,766	5,768	5,782
Diluted	7,181	7,215	7,267	7,433

	Quarters Ended			
	March 31, 2009	June 30, 2009	Sept. 30, 2009	Dec. 31, 2009
	(in thousands, except per share amounts)			
Net revenues	$6,496	$8,334	$8,600	$8,673
Cost of revenues	4,051	4,636	4,867	4,150
Gross profit	2,445	3,698	3,733	4,523

Income before provision for income taxes	2,436	1,538	693	1,151
Net income	2,279	1,504	710	1,171
Net income attributable to Southwall	2,279	1,504	710	1,171
Deemed dividend on preferred stock	122	122	122	123
Net income attributable to common stockholders	$2,157	$1,382	$588	$1,048
Net income per share (1):				
Basic	$0.38	$0.24	$0.10	$0.18
Diluted	$0.34	$0.22	$0.10	$0.16
Weighted average shares used in computing net income per share (1):				
Basic	5,741	5,742	5,746	5,755
Diluted	6,754	6,760	6,937	7,138

(1) All share and per share amounts have been retroactively restated for all periods presented to reflect our 1-for-5 reverse stock split described in Note 1 to these consolidated financial statements.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(amounts in thousands, except per share data)

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Item 6, "Selected Consolidated Financial Data", our consolidated financial statements and notes thereto appearing elsewhere in this report and the risk factors set forth in Item 1A, “Risk Factors”. This discussion and analysis contains forward-looking statements that involve risks and uncertainties. You should not place undue reliance on these forward-looking statements. Our actual results may differ materially from those anticipated in these forward-looking statements. A brief description of the forward-looking statements appears immediately preceding Item 1, “Business”, and a discussion of certain factors that may cause our actual results to differ from those anticipated in the forward-looking statements appears in Item 1A, “Risk Factors”.

Overview

Southwall is a developer and manufacturer of high performance films and glass products that improve energy efficiency in architectural and automotive glass applications. Founded in response to the oil embargo of 1973, Southwall has approximately 35 years of experience and commercial adoption of its products worldwide. Our products enable green building and transportation customers to decrease carbon emissions and reduce the use of oil and electricity in the heating and cooling of buildings and vehicles.

Our customers were not immune to the global economic downturn of 2009. We believe both the architectural and automotive industries experienced material sales declines, which negatively impacted our financial results in 2009 and into early 2010. In 2010, we started to see increased sales of our products in the automotive film and window markets as a result of higher sales of automobiles in 2010 and the overall continuing recovery from the global economic downturn in 2009 and 2008.

In 2010, we acquired a controlling interest in Southwall Insulating Glass, LLC (“Southwall Insulating Glass” or “SIG”), a joint venture between our wholly-owned subsidiary Southwall IG Holdings Inc. and Sound Solutions Windows & Doors, LLC (“Sound Solutions"). On April 8, 2008, Southwall IG Holdings, Inc., a wholly owned subsidiary of Southwall Technologies Inc., entered into a Joint Venture Agreement with Sound Solutions Window & Doors, LLC (“Sound Solutions”), creating SIG, which manufactures insulated glass units for the domestic market to further expand the market for the Company’s Heat Mirror product. As of December 31, 2009, Southwall IG Holdings, Inc. had a 50% investment in SIG. In 2009, Southwall IG Holdings, Inc. advanced a total of $300, in the form of a promissory note, to Sound Solutions. Pursuant to the terms of the promissory note dated May 11, 2009, the principal and accrued interest was due and payable to Southwall IG Holdings, Inc. by January 1, 2010. Under terms of the note, in the event of default, the outstanding principal was to be paid in the form of a credit to the Southwall IG Holdings, Inc. capital account.

Effective January 1, 2010, Sound Solutions had not paid the principal balance of $300 and was in default of the promissory note. The $300, for which Sound Solutions had received equity consideration in SIG, was credited to Southwall IG Holdings, Inc.’s capital account in SIG; thereby increasing our equity ownership to 66.3%.

On May 20, 2010 the joint venture agreement was amended allowing Southwall IG Holding, Inc. to make additional cash contributions to the joint venture. In order to acquire an additional 8.7% to obtain 75% equity ownership, Southwall IG Holding, Inc. relinquished $256 of the amount owed to it from Sound Solutions, and Sound Solutions maintained a 25% equity interest in SIG. This transaction triggered a business combination event which resulted in the consolidation of total assets and liabilities of SIG resulting in a gain of $706, which was recorded in other income

(expense) net, to adjust the equity interest in SIG to a fair value of $919 before the acquisition date.

As a result of our acquisition of a controlling interest in SIG in May 2010, we operate in two segments: film, which includes our development and manufacture of thin film coatings on flexible substrates, and glass, which includes the production and sale of glass units through Southwall Insulating Glass. Since we did not acquire a controlling interest in SIG until May 2010, there is no information for the years ended December 31, 2009 and 2008 for comparison purposes. Prior to the year ended December 31, 2010, we operated only in one segment. The Chief Operating Decision Maker ("CODM") is our President and Chief Executive Officer. The CODM allocates resources to and assesses the performance of each operating segment using information about its revenue and operating income (loss). Selected financial data for each segment can be found in Note 8, Segment Reporting, to the accompanying consolidated financial statements.

In August 2010, we purchased substantially all of the assets of Crown Operations International, LTD ("Crown Operations"). Crown Operations is a Wisconsin-based processor of high performance, heat reflective interlayers that improve the energy efficiency of laminated glass in buildings, homes and cars. The assets acquired include, primarily, a 22,000 sq ft manufacturing facility, situated on four acres of land, and converting equipment located in Sun Prairie, Wisconsin. The purchase price was $3,302, consisting of $2,052 in cash and the $1,250 in term debt. We expect the acquisition of these assets to provide additional integration and improvement of our production processes enabling us to bring new, energy-saving interlayer products to the market. We also believe that the Crown Operations' laminating and converting capabilities simplify material logistics and facilitate the adoption of high performance interlayers for volume production. We believe we are now positioned to provide a complete interlayer solution from encapsulation through converting in furtherance of our goal of making it easier for manufacturers to integrate the performance of Southwall's XIR heat-reflective film into their architectural and automotive laminated glass products.

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Recent Events

On March 9, 2011, we completed a 1-for-5 reverse stock split of our common stock, pursuant to previously obtained stockholder approval on May 12, 2010. The reverse stock split reduced the number of shares of our common stock issued and outstanding from approximately 28.8 million to approximately 5.8 million. In connection with the reverse stock split, we also reduced the number of our authorized shares of common stock from 50 million to 10 million to reflect the reverse stock split ratio. All share and per share amounts herein are presented on a post-reverse stock split basis, other than the consolidated balance sheet at December 31, 2009 and the consolidated statements of stockholders' equity for the years ended December 31, 2007 through December 31, 2009.

In 2010, we were awarded a three-year grant of $1,445 from the U.S. Department of Energy to develop advanced technologies aimed at making homes and buildings more energy efficient. We have used and will continue to use the funding to accelerate development of higher performance and lower cost Heat Mirror low-emissivity and solar-reflective films and multi-cavity, suspended-film insulating glass technology to enable the broad commercialization of "super-insulating" R-10 windows.

Financing and Related Transactions

On December 18, 2003, we entered into an investment agreement with Needham & Company, Inc., Needham Capital Partners II, L.P., Needham Capital Partners II (Bermuda), L.P., Needham Capital Partners III, L.P., Needham Capital Partners IIIA, L.P., Needham Capital Partners III (Bermuda), L.P. (together referred to as "Needham Company and its Affiliates") and Dolphin Direct Equity Partners, L.P. (collectively with Needham Company and its Affiliates ("the Investors"). Through a series of transactions, we issued an aggregate of 4,893 shares of Series A Preferred Stock. Needham Company and its Affiliates received 3,262 shares of Series A Preferred Stock and Dolphin Direct Equity Partners, L.P. received 1,631 shares of Series A Preferred Stock.

Each share of the Series A Preferred Stock shares has a stated value of $1.00 and is entitled to a cumulative dividend of 10% per year, payable at the discretion of the Board of Directors. Dividends on the Series A Preferred Stock accrue daily commencing on the date of issuance and are deemed to accrue whether or not earned or declared and whether or not there are profits, surplus or other funds legally available for the payment of dividends. Accumulated dividends, when and if declared by the Board of Directors, will be paid in cash. At December 31, 2010, $2,935 of deemed dividends on the Series A Preferred Stock had been accrued to date.

Each share of the Series A Preferred Stock is convertible into common stock at any time, at the option of the holder, at the conversion price of $5.00 per share, subject to certain adjustments.

As of December 31, 2010 and 2009, Needham & Company, Inc. and its affiliates and Dolphin Direct Equity Partners, L.P. owned common stock and securities convertible into common stock, constituting in the aggregate 61.5% and 61.9%, respectively, of our potentially outstanding common stock.

Upon a liquidation or dissolution of the Company, the holders of Series A Preferred Stock are entitled to be paid a liquidation preference out of assets legally available for distribution to our stockholders before any payment may be made to the holders of common stock. The liquidation preference is equal to $1.00 per share, plus any accumulated but unpaid dividends. Mergers, the sale of all or substantially all of our assets, the acquisition of the Company by another entity and certain other similar transactions may be deemed to be liquidation events for these purposes.

Portfolio Financial Servicing Company, Bank of America and Lehman Brothers. On February 20, 2004, we entered into a settlement agreement with Portfolio Financial Servicing Company (as successor to Matrix Funding Corporation), Bank of America and Lehman Brothers, which extinguished a claim arising out of sale-leaseback

agreements with Matrix Funding Corporation, which we entered into in connection with the acquisition of two of our production machines. As part of the settlement, we agreed to pay a total of $2,000 plus interest over a period of six years. The settlement required us to make an interest payment in 2004, and beginning in 2005, to make quarterly principal and interest payments through 2010. We also agreed to return the production machines in question. During the first quarter of 2009, we paid $995, as complete settlement of all obligations, including principal and interest. Upon final payment of principal and interest, a formal release of the obligation under the 2004 settlement agreement was obtained from Portfolio Financial Servicing Company on January 21, 2009, and a gain of $2,359 was recognized in the first quarter of 2009 in other income (expense), net, in the accompanying consolidated statements of operations.

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Results of Operations

Consolidated Statements of Operations Data:
(dollars in thousands)

	Years Ended December 31,				
	2010	Percent Change	2009	Percent Change	2008
Net revenues:					
Film					
Automotive film	$ 19,898	24 %	$ 16,040	(17)%	$ 19,298
Window film	17,178	84	9,346	(40)	15,691
Architectural	5,509	(13)	6,353	-	6,358
Other	389	7	364	(36)	573
Total film	42,974	34	32,103	(23)	41,920
Glass	2,043	-	-	-	-
Total net revenues	45,017	40	32,103	(23)	41,920
Cost of revenues	24,962	41	17,704	(27)	24,378
Gross profit	20,055	39	14,399	(18)	17,542
Operating expenses:					
Research and development	3,733	30	2,874	(4)	2,996
Selling, general and administrative	10,010	25	8,037	(2)	8,199
Restructuring (recoveries) expenses, net	-	(100)	(56)	nm*	-
Total operating expenses	13,743	27	10,855	(3)	11,195
Income from operations	6,312	78	3,544	(44)	6,347
Interest expense, net	(295)	(48)	(570)	(3)	(586)
Other income (expense), net	102	(96)	2,844	nm*	(62)
Income before provision for (benefit from) income taxes	6,119	5	5,818	2	5,699
Provision for (benefit from) income taxes	(3,678)	nm*	154	(70)	511
Net income	9,797	73	5,664	9	5,188
Net loss attributable to noncontrolling interest	(334)	nm*	-	-	-
Net income attributable to Southwall	10,131	79	5,664	9	5,188
Deemed dividend on preferred stock	489	-	489	-	489
Net income attributable to common stockholders	$ 9,642	86	$ 5,175	10	$ 4,699

* not meaningful

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The following table sets forth our results of operations expressed as a percentage of total revenues:

	Years Ended December 31,		
	2010	2009	2008
Net Revenues:			
Film:			
Automotive film	44.2%	50.0%	46.0%
Window film	38.2	29.1	37.4
Architectural	12.2	19.8	15.2
Other	0.9	1.1	1.4
Total film	95.5	100.0	100.0
Glass	4.5	-	-
Total net revenues	100.0	100.0	100.0
Cost of revenues	55.5	55.2	58.2
Gross profit	44.5	44.8	41.8
Research and development	8.3	9.0	7.1
Selling, general and administrative	22.2	25.0	19.6
Restructuring (recoveries) expenses, net	-	(0.2)	-
Total operating expenses	30.5	33.8	26.7
Income from operations	14.0	11.0	15.1
Interest expense, net	(0.7)	(1.8)	(1.4)
Other income (expense), net	0.2	8.9	(0.1)
Income before provision for (benefit from) income taxes	13.5	18.1	13.6
Provision for (benefit from) income taxes	(8.2)	0.5	1.2
Net income	21.7	17.6	12.4
Net loss attributable to noncontrolling interest	(0.7)	-	-
Net income attributable to Southwall	22.4	17.6	12.4
Deemed dividend on preferred stock	1.1	1.5	1.2
Net income attributable to common stockholders	21.3%	16.1%	11.2%

Net revenues

Net revenues in 2010, 2009 and 2008 were $45,017, $32,103 and $41,920, respectively. Net revenues for 2010 increased by $12,914, or 40%, from 2009, primarily due to increased demand for our products in the automotive film and window film markets as a result of higher sales of automobiles in 2010 and the overall continuing recovery from the global economic downturn in 2009 and 2008. Net revenues for 2009 decreased by $9,817, or 23%, from 2008.

Our 2010 net revenues in the automotive film market increased by $3,858, or 24%, from $16,040 in 2009 to $19,898 in 2010. The increase was primarily due to increased demand resulting from higher sales of automobiles in 2010 as the global economy continued to improve in 2010. Our 2009 net revenues in the automotive film market decreased by $3,258, or 17%, from $19,298 in 2008. The decrease was primarily due to decreased demand from some of our larger customers and to a lesser extent the Euro exchange rate, as many of our customers are billed in Euros.

Our 2010 net revenues in our window film market increased by $7,832, or 84%, from $9,346 in 2009 to $17,178 in 2010. The increase was primarily due to higher sales of automobiles in 2010 and increased demand for after-market applied window film products for the automotive market. Our net revenues in our window film market decreased $6,345, or 40%, to $9,346 in 2009 from $15,691 in 2008. The decrease was primarily due to decreased overall demand in the window film business.

Net revenues in our architectural film market decreased in 2010 by $844, or 13%, from $6,353 in 2009 to $5,509 in 2010. The decrease was primarily due to the delayed shipment of material for a major project. Our 2009 net revenues in the architectural film market remained essentially unchanged as compared to revenues of $6,358 in 2008.

Net revenues in our glass segment of $2,043 in 2010 are related to our acquisition of a controlling interest in SIG in May 2010. Net revenues reflect sales of our energy efficient, dual-pane and multi-cavity insulated glass units used in the production of completed windows for the residential housing and commercial building markets.

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Cost of Revenues

Cost of revenues increased $7,258, or 41%, from $17,704 in 2009 to $24,962 in 2010. Cost of revenues decreased $6,674, or 27%, to $17,704 in 2009 from $24,378 in 2008. As a percent of net revenues, cost of revenues was 55.5% in 2010 compared to 55.2% in 2009. Facility costs, depreciation expense and labor costs have historically comprised the majority of our manufacturing expenses. Since these costs are relatively fixed and do not fluctuate proportionately with net revenues, the increase in the cost of revenues was due primarily to higher variable costs as manufacturing volume increased to support the increased sales demand, the consolidation of SIG's operations following our acquisition of a controlling interest in SIG, which has higher cost of revenues on a percentage of net revenues compared to our other business and smaller inventory reserve charge in 2010 compared to 2009. Cost of revenues decreased 27% or $6,674 in 2009 from 2008. As a percent of net revenues, cost of revenues was 55.2% in 2009 compared to 58.2% in 2008. The decrease in cost of revenues in 2009 from 2008 was primarily due to lower variable costs from reduced manufacturing volume and to a lesser extent cost saving programs, such as furloughs and more efficient recycling of precious metals used in the manufacturing process, implemented in 2009 to offset fixed costs.

Gross margin

Gross margin was 44.5% in 2010 compared with 44.8% in 2009. The relative lack of change in gross margin was primarily the result of higher manufacturing volume to support the increased sales demand offset by lower margins from the consolidation of SIG's operations following our acquisition of a controlling interest in SIG. Gross margin increased to 44.8% in 2009 from 41.8% in 2008. The increase in gross margin was largely the result of the lower reserves for returns and allowances attributed to lower sales and a lower amount of credits issued for quality issues and cost saving programs implemented in 2009 to offset fixed costs and lower volumes.

Operating expenses

Research and development expenses increased $859, or 30%, from $2,874 in 2009 to $3,733 in 2010. The increase was primarily attributable to increased research and development activities in new technology. Research and development expenses in 2009 remained essentially unchanged year over year at $2,874, or 9.0%, of net revenues, compared to $2,996, or 7.1%, of net revenues in 2008. The slight reduction in cost was primarily the result of lower compensation costs offset by an increase in research and development efforts relating to thin film technology.

Our selling, general and administrative expenses increased $1,973, or 25%, from $8,037 to $10,010 in 2010. The increase was largely due to higher sales and marketing costs, higher consulting and legal expenses and general and administrative expenses due to the consolidation of the operations of SIG and our acquisition of the assets of Crown Operations. Selling, general and administrative expenses decreased slightly in 2009 as compared to 2008. The $162 decline, or 2%, was due to lower discretionary spending, offset by the settlement of the Pilkington patent matter.

Income from operations

Income from operations increased to $6,312 in 2010 from $3,544 in 2009. The increase was a result of higher revenues and manufacturing volumes in 2010 due primarily to increased demand of our automotive and window film products, partially offset by higher operating expenses primarily resulting from the consolidation of the operations of SIG and our acquisition of the assets of Crown Operations. Income from operations decreased to $3,544 in 2009 from income of $6,347 in 2008 as a result of lower revenues and sales volumes in 2009.

Interest expense, net

Interest expense, net, decreased to $295 in 2010 compared to $570 in 2009 mainly due to the interest expense recorded in 2009 relating to the settlement of a patent matter with Pilkington PLC, partially offset by interest expense related to higher debt obligations in 2010. Interest expense, net, decreased to $570 in 2009 compared to $586 in 2008 mainly due to lower debt obligations, partially offset by interest expense relating to the settlement of the Pilkington patent matter.

Other income (expense), net

Other income (expense), net, was income of $102 in 2010 compared to income of $2,844 in 2009. Other income of $102 in 2010 is primarily comprised of a recognized gain of $706 resulting from our acquisition of a controlling interest in SIG, partially offset by our 66.3% share of net losses incurred by SIG of $333 through May 20, 2010, and a foreign exchange loss relating to transactions with foreign customers that were denominated in foreign currencies, principally the Euro, of $333.

Other income, net, in 2009 was $2,844, an increase from expense of $62 in 2008. Other income, net in 2009 primarily relates to our final payment in January 2009 of our 2004 debt settlement agreement with Portfolio Financial Servicing Company (as successor to Matrix Funding Corporation), which settled our dispute with Matrix concerning certain sale-leaseback agreements for production machines. In 2009, we recognized a $2,359 gain on the reversal of the remaining carrying value of the accrued liability associated with the debt. Also included in other income, net was the final milestone payment of $500 received from Sunfilm in the second quarter of 2009 and the reversal of a $220 (150 Euros) reserve associated with the Saechsische AufbauBank (SAB) grants in Germany. In addition, in February 2009, we sold precious metal targets that remained after our Palo Alto, California manufacturing facility was closed in 2006 and production was moved to Germany. The targets had previously been expensed in 2006, and therefore, the sale resulted in a net gain of $346 to other income, net in the first quarter of 2009. These nonrecurring gains were partially offset by $733, representing our portion of the net losses incurred by SIG during 2009.

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Income before provision for (benefit from) income taxes

Income before provision for (benefit from) income taxes increased to $6,119 in 2010 compared to $5,818 in 2009, as a result of higher gross margins, partially offset by higher operating expenses. Income before provision for (benefit from) income taxes increased slightly to $5,818 in 2009 compared to $5,699 in 2008, as a result of higher gross margins, lower operating expenses, and approximately $2,844 of other income, net.

Provision for (benefit from) income taxes

We calculate our income taxes based on an annual effective tax rate in compliance with ASC 740, Accounting for Income Taxes. Under ASC 740, income tax expense is recognized for the amount of taxes payable or refundable for the current year, and for deferred tax assets and liabilities for the tax consequences of events that have been recognized in an entity's financial statements or tax returns.

In preparing our consolidated financial statements, we estimate our income taxes for each of the jurisdictions in which we operate. We include differences between the financial and tax basis amounts as deferred tax assets, such as net operating loss carryforwards ("NOLs"), and deferred tax liabilities in our consolidated balance sheets. We then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent we believe that recovery is not likely, we establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in any period, we include an expense within the tax provision in our statement of operations.

In the United States, prior to 2007, we had a history of losses and, as a result, have historically provided for a valuation allowance for net deferred tax assets. Each quarter, we evaluate the need to retain all or a portion of the valuation allowance on our net deferred tax assets. During 2010, we determined that it was more likely than not that the deferred tax assets, including NOLs, would be realized, and as a result, released $12,833 of the valuation allowance. In making this determination, we analyzed, among other things, our recent history of earnings, our cumulative earnings for the last 12 quarters, and forecasts of future earnings. The reversal of the valuation allowance resulted in an income tax benefit of $4,535 for the year ended December 31, 2010, and an increase in the current and non-current deferred tax assets on the consolidated balance sheet as of December 31, 2010.

Significant management judgment is required in determining our provisions for income taxes, our deferred tax assets and liabilities and our future taxable income for purposes of assessing our ability to utilize any future tax benefit from our deferred tax assets. If actual results differ from these estimates or we adjust these estimates in future periods, our financial position, cash flows and results of operations could be materially affected.

Liabilities are recorded for more likely than not income tax assessments based on estimates of potential tax related exposures, and utilizes a recognition threshold and measurement approach for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Differences between actual results and assumptions, or changes in assumptions in future periods, are recognized in the period they become known.

See Note 7 - Income Taxes, of the accompanying consolidated financial statements included in Item 8 for additional information on ASC 740.

Net income

The increase in net income to $10,131 in 2010 from $5,644 in 2009 was largely due to higher gross margins and a recognized income tax benefit, partially offset by higher operating expenses.   The increase in net income to $5,664 in 2009 from $5,188 in 2008 was primarily due to higher gross margins and lower operating expenses, approximately $2,844 of other income, net, and a slightly lower tax provision in 2009 compared to 2008.

Net loss attributable to noncontrolling interest

The net loss attributable to noncontrolling interest in 2010 is related to the consolidation of SIG upon our acquisition of a controlling interest in May 2010, representing Sound Solutions' ownership interest in SIG.

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Deemed dividend on preferred stock

We accrued $489 of deemed dividend on our Series A Preferred Stock in each of the years 2010, 2009 and 2008. The Series A Preferred Stock carries a 10% cumulative dividend rate.

Segment Information

With the acquisition of a controlling interest in SIG in May 2010, we now operate in two segments:

- Film, which includes the manufacturing of thin film coatings on flexible substrates, and
- Glass, which includes the manufacturing of integrated glass units.

Since we did not acquire a controlling interest in SIG until May 2010, there is no information for the years ended December 31, 2009 and 2008 for comparison purposes.

Film segment net revenues for 2010 increased $10,871, or 34%, to $42,974 from 2009, which was due to increased demand for our products in the automotive film and window film markets resulting from higher sales of automobiles in 2010 and the overall continuing recovery from the global economic downturn in 2009 and 2008. For 2010, the Film segment operating income was $8,177, compared to operating income of $3,544 in 2009, resulting primarily from higher revenue in 2010. Film segment net revenues for 2009 decreased $9,817, or 23%, to $32,103 from 2008 primarily as a result of the global economic recession. The Film segment operating income decreased to $3,544 in 2009 from operating income of $6,347 in 2008 primarily due to lower revenue in 2009.

Glass segment revenues for 2010 were $2,043, primarily due to sales of our energy efficient, dual-pane and multi-cavity insulated glass units used in the production of completed windows for the residential housing and commercial building markets. The Glass segment's operating loss for 2010 was $1,865 primarily due to higher cost of revenues and research and development costs.

Liquidity and Capital Resources

Liquidity

Our principal liquidity requirements are for working capital, consisting primarily of accounts receivable and inventories, debt repayments and capital expenditures. We believe that because of the relatively long production cycle of certain of our products, our inventories will continue to represent a significant portion of our working capital. We generated net income and had positive cash flow from operations in 2010, 2009 and 2008.

For the quarters ended December 31, 2010 and December 31, 2009, our days sales outstanding ("DSO") were 61 days and 62 days, respectively and were essentially unchanged. Our write-off of bad debts for the years ended December 31, 2010, 2009 and 2008 were $2, $47 and $145, respectively.

Our cash and cash equivalents increased by $1,322 from $12,454 at December 31, 2009 to $13,776 at December 31, 2010. Cash provided by operating activities was $5,606 in 2010. The cash provided by operating activities during 2010 was primarily the result of net income for the year of $9,797, a decrease in accounts receivable of $657, non-cash depreciation and stock-based compensation expense of $2,813 and $628, respectively, and recovery of returns and allowances reserves of $594, offset by non-cash gain on acquisition of controlling interest in SIG of $706, an increase in inventory of $622, an increase in other current and noncurrent assets of $2,030, an increase in deferred income tax of $4,414 and a decrease in accounts payable and accrued liabilities of $595.

Cash used in investing activities in 2010 was $5,385 compared to $1,430 in 2009. The cash used in investing activities during 2010 was primarily for the acquisition of the assets of Crown Operations of $3,302, capital expenditures of $1,888 and the acquisition of the controlling interest in SIG of $195.

Cash provided by financing activities in 2010 was $998 compared to cash used in financing activities of $1,967 in 2009. The cash provided by financing activities in 2010 was primarily the result of term loan and equipment financing borrowings of $1,250, an investment tax credit of $379 (285 Euros) received in the third quarter of 2010 and proceeds from the exercise of stock options of $273, offset by scheduled payments related to term debt and capital lease obligations of $921.

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Our cash and cash equivalents increased by $1,686 from $10,768 at December 31, 2008 to $12,454 at December 31, 2009. Cash provided by operating activities was $5,228 in 2009. The cash provided by operating activities during 2009 was primarily the result of net income for the year of $5,664, a decrease in inventory of $1,354, and non-cash depreciation and stock-based compensation expense of $2,596 and $403, respectively, offset by the non-cash gain of $2,359 resulting from the reversal of the long-term reserve associated with the settlement of the Matrix Funding Corporation ("Matrix") debt, an increase in accounts receivable of $2,230 attributed to several large shipments that occurred in December 2009 and a provision for returns and allowance reserves of $784.

Cash used in investing activities in 2009 was $1,430 compared to cash provided by investing activities of $563 in 2008. The cash used in investing activities in 2009 was primarily for capital expenditures of $1,725, the majority of which was used for the upgrade of a production machine in our German manufacturing facility. These investments were partially offset by the release of $261 of restricted cash to cash and cash equivalents in the first quarter of 2009. This reclassification was associated with the expiration of contractual obligations relating to consigned precious metals in Germany, which required a cash deposit.

Cash used in financing activities of $1,967 in 2009 was comprised primarily of our settlement of the Matrix term debt in the first quarter 2009 and other debt payments totaling $2,242 in aggregate. The final debt payment with Matrix was $995 and scheduled payments related to other term debt and capital lease obligations represented $1,247. Cash used for the retirement of debt obligations in 2009 was partially offset by proceeds from the exercise of stock options of $54 and an investment tax credit of $221 (165 Euros) received in the second quarter 2009 for fixed asset purchases in Germany.

We entered into an agreement with the Saxony government in Germany in May 1999 under which we received investment grants. As of December 31, 2010, we had received approximately 5,000 Euros of the grants and accounted for these grants by applying the proceeds received to reduce the cost of our fixed assets at our Dresden manufacturing facility. As of December 31, 2010, all government grants had been applied or repaid eliminating restricted cash.

Borrowing arrangements

As of December 31, 2010, we were in compliance with all financial covenants under all of our financial instruments.

Borrowing Arrangements with Wells Fargo Bank

In June 2009, we entered into a Credit Agreement with Wells Fargo Bank ("Bank"). The Credit Agreement provides for a $3,000 revolving line of credit. Advances under the line exceeding $1,500 are limited to 80% of eligible accounts receivable. We are not eligible for additional borrowings if our consolidated cash balance falls below $3,500. Amounts borrowed under the facility bear interest at either prime plus 0.75% or LIBOR plus 3.5%, determined at our discretion, and is annualized on the average daily financed amount outstanding. All borrowings under the facilities are collateralized by our assets in the United States and are subject to certain covenants including minimum quarterly net income and minimum liquid asset requirements. Generally, if any event of default occurs, the Bank may declare all outstanding indebtedness under the Credit Agreement to be due and payable. The maturity date of the facility is June 2011. Although we expect to renew the credit line, we can provide no assurance that we will be successful in obtaining a new or replacement credit facility upon acceptable terms. As of December 31, 2010, we had no balance outstanding on our line of credit.

In August 2010, our Credit Agreement with the Bank was amended to provide for a $1,250 term loan, which was funded on September 2, 2010. Amounts borrowed under the term loan are payable over 36 months in equal installments and bear interest at a fixed rate of 4.05%. The Credit Agreement was further amended to provide covenants for tangible net worth and fixed charge coverage ratio.

On December 27, 2010, we entered into a lease agreement with the Bank to finance research and development equipment. The lease term is 48 months and requires monthly payments. As of December 31, 2010, the principal balance of this lease was $270.

We have classified $480 and $936 outstanding under the Bank term loan and capital lease as a short-term liability and long-term liability, respectively, at December 31, 2010. We are obligated to pay an aggregate of $417 in principal under our Wells Fargo term loan in 2011.

As of December 31, 2010, we were in compliance with all covenants under the Credit Agreement and capital lease.

Borrowing Agreements with German Banks

Our borrowing arrangements with various German banks as of December 31, 2010 are described in Note 5 of the Notes to Consolidated Financial Statements (Item 8. “Financial Statements and Supplementary Data”) set forth herein. We are in compliance with all of the covenants of the German bank loans and capital leases, and we have classified $414 and $2,512 outstanding under the German bank loans as a short-term liability and long-term liability, respectively, at December 31, 2010. We are obligated to pay an aggregate of $331 in principal under our German bank loans in 2011.

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U.S. Capital Leases

Our borrowing arrangements with a U.S. capital leasing institution as of December 31, 2010 is described in Note 5 of the Notes to Consolidated Financial Statements (Item 8. "Financial Statements and Supplementary Data") set forth herein. We are in compliance with all of the covenants of the capital lease, and we have classified $130 and $63 outstanding under the capital lease as a short-term liability and long-term liability, respectively, at December 31, 2010. We are obligated to pay an aggregate of $130 in principal under our U.S. capital lease agreement in 2011.

Settlement with Matrix Funding Corporation

In 2003, we were in default under a master sale-leaseback agreement with respect to two of our production machines. We had withheld lease payments in connection with a dispute with the leasing company, Matrix Funding Corporation. In February 2004, we reached a settlement agreement for approximately $2,000 to be repaid over six years at a stepped rate of interest, and we returned the equipment in question. At December 31, 2008, the carrying value of the liability was $3,354. In January 2009, we arrived at a final settlement agreement for $995, which was considered full and final payment of principal and interest. A formal release of all obligations under the 2004 settlement agreement was obtained from the Portfolio Financial Servicing Company, the successor to Matrix Funding Corporation, on January 21, 2009. Currently there is no outstanding debt to this creditor.

Capital expenditures

Capital expenditures were $1,888 and $1,725 in 2010 and 2009, respectively. The capital expenditures were primarily related to the upgrade of our production machines and facilities, as well as to research and development tools. We expect to spend approximately $7,600 in 2011 primarily related to machinery and equipment for Heat Mirror automation and additional equipment investment in our Germany facility.

Future Obligations

Our future payment obligations on our borrowings pursuant to our term debt, non-cancelable operating leases and other non-cancelable contractual commitments are as follows at December 31, 2010 (in thousands):

	Total	Less Than 1 Year	1-3 Years	3-5 Years	Greater Than 5 Years
Contractual Obligations:					
Term debt (1)	$ 3,962	$ 748	$ 1,392	$ 663	$ 1,159
Capital lease obligations (1)	573	276	225	72	-
Term debt and capital lease obligation interest (1)	841	231	295	182	133
Other obligations (2)	2,935	-	-	-	2,935
Operating leases (3)	1,151	591	560	-	-
Total Contractual Cash Obligations	$ 9,462	$ 1,846	$ 2,472	$ 917	$ 4,227

(1) Represents the principal and interest allocations of loan and capital lease agreements with Varilease Finance Inc., Wells Fargo Bank and several German Banks.

(2) Represents accumulated dividends accrual on Series A Preferred Stock (greater than five years).

(3) Represents the remaining rents owed on buildings we rent in Palo Alto, California, and Chicago, Illinois.

Interest obligations relating to our term debt and capital lease obligations declined for the year ended December 31, 2010 to $304 from $401 for the year ended December 31, 2009.

As of December 31, 2010, we maintained 30,174 square feet of office and warehouse space at 3780-3788 Fabian Way, Palo Alto, California 94303. The terms of the leases for these facilities continue through June 30, 2011. The monthly rent payment for this facility was $39 for 2010. In 2011, the monthly rent payments will increase to $40 through the expiration of the lease. In February 2011, we terminated the existing and entered into a new lease for this space, which expires in 2016.

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As of December 31, 2010, we also had a lease obligation for 9,200 square feet at 3961 East Bayshore Road, Palo Alto, California 94303. This manufacturing space is currently vacant. The monthly rent payment for this facility in 2010 was $4. In 2011, the rent payments will be $4. The lease expires on December 31, 2011.

As of December 31, 2010, we had a lease obligation for 75,640 square feet at 4404 W. Ann Lurie Place, Chicago, Illinois 60632 for the operations of SIG. The monthly rent payment for this facility in 2010 was $20. In 2011, the monthly rent payments are $20, which increases to $25 in April 2011, $26 in October 2011, and increases thereafter annually at a rate of 3.6% through the expiration of the lease in 2013.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the amounts of assets and liabilities we report, our disclosure of contingencies, and the amounts of revenues and expenses we report in our consolidated financial statements. If we used different judgments or estimates, or assumptions there might be material differences in the amount and timing of revenues and expenses we report. See Note 1 of our Notes to Consolidated Financial Statements (Item 8. "Financial Statements and Supplementary Data") for details regarding our accounting policies. The critical accounting policies, judgments, estimates and assumptions which we believe have the most significant effect on our consolidated financial statements, are set forth below:

- Revenue recognition;
- Stock-based compensation;
- Allowances for doubtful accounts and sales returns;
- Valuation of inventories;
- Assessment of the probability of the outcome of current litigation;
- Valuation of long-lived assets;
- Impairment of intangibles and goodwill; and
- Accounting for income taxes.

Revenue recognition. We recognize revenues when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectibility is reasonably assured. Accordingly, we generally recognize revenues from product sales when the terms of the sale transfer title and risk of loss, which occurs either upon shipment or upon receipt by customers, net of any sales, use, value added or certain excise taxes imposed by governmental authorities. We account for estimated returns and allowances. We adjust these allowances periodically to reflect our actual and anticipated experience. If any of these conditions to recognize revenues are not met, we defer revenue recognition.

Stock-Based Compensation. We account for stock-based compensation under the fair value recognition provisions of ASC 718, Compensation – Stock Compensation. Stock-based compensation expense in fiscal 2010, 2009 and 2008 included stock-based compensation expense for all share-based payment awards granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of ASC 718. Stock-based compensation expense for all share-based payment awards granted after January 1, 2006, is based on the grant-date fair value estimated in accordance with the provisions of ASC 718. ASC 718 requires companies to

estimate the fair value of share-based payment awards on the date of grant using an option pricing model. We use the Black-Scholes option pricing model, which requires assumptions requiring a high degree of judgment. The value portion of the award that is ultimately expected to vest is recognized as compensation expense on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of four years.

Allowances for doubtful accounts and sales returns. We establish allowances for doubtful accounts and sales returns for specifically identified, as well as anticipated, doubtful accounts and product quality and warranty claims based on credit profiles of our customers, current economic trends, contractual terms and conditions, and historical payment, sales returns and claims experience. As of December 31, 2010, our consolidated balance sheet included allowances for doubtful accounts and sales returns of $128 and $1,187, respectively. As of December 31, 2009, our consolidated balance sheet included allowances for doubtful accounts and sales returns of $115 and $607, respectively. During 2010 and 2008 we recorded sales return costs of $1,065 and $1,247, respectively, and in 2009, a credit of $326. We incurred bad debt expense of $16 and $264 in 2010 and 2008, respectively and a credit to bad debt expense of $23 in 2009. These credits were incurred as a result of our customers paying written-off receivable balances. If our actual bad debt and product quality and sales returns costs differ from our estimates, or if we adjust our estimates in future periods, our operating results, cash flows and financial position could be materially adversely affected.

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Valuation of inventories. We state inventories at the lower of cost or market. We establish provisions for excess, obsolete, impaired and non-standard width inventories after periodic evaluation of historical sales, current economic trends, forecasted sales, predicted lifecycle and current inventory levels. As of December 31, 2010, 2009 and 2008, our reserve balances totaled $562, $993 and $1,100, respectively, primarily for impaired and non-standard width inventories. Subcontractor yields can adversely impact the scrap rate of inventory during a particular period. The timing of the disposal of impaired and non-standard width inventories can materially impact the balance of inventory reserves.

Assessment of the probability of the outcome of current litigation. In the ordinary course of business, we have periodically become engaged in litigation principally as a result of disputes with customers of our architectural products. We have relied upon insurance coverage to fund the defense of these actions and significant portions of the settlements that were reached. Based on our review of pending litigation, we record accruals for loss contingencies when we believe that a liability is likely of being incurred and we can reasonably estimate the amount of our share of the loss.

Valuation of long-lived assets. We assess the valuation of long-lived assets if events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that could trigger an impairment review include the following: (i) significant negative industry or economic trends; (ii) exiting an activity in conjunction with a restructuring of operations; (iii) current, historical or projected losses that demonstrate continuing losses associated with an asset; or (iv) a significant decline in our market capitalization, for an extended period of time, relative to net book value. When we determine that there is an indicator that the carrying value of long-lived assets may not be recoverable, we measure impairment based on estimates of future cash flows. These estimates include assumptions about future conditions such as future revenues, gross margins, operating expenses, the fair values of certain assets based on appraisals, and industry trends.

Intangible Assets. We perform a quarterly review of intangible assets to determine if facts and circumstances indicate that the useful life is shorter than we had originally estimated or that the carrying amount of assets may not be recoverable. If such facts and circumstances exist, we assess the recoverability of identified intangible assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairments, if any, are based on the excess of the carrying amount over the fair value of those assets

Goodwill. Goodwill represents the cost of business acquisitions in excess of the fair value of identifiable net tangible and intangible assets acquired. Goodwill is allocated to the appropriate reporting unit as reviewed by our chief decision maker responsible for reviewing operating performance and allocating resources. Goodwill is tested annually during the fourth quarter, or when events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. Impairment of goodwill is evaluated using a two step process. First, the fair value of the reporting unit is compared with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired, and thus, the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. As of December 31, 2010, no impairment charges have been recorded against goodwill.

Accounting for income taxes. In preparing our consolidated financial statements, we estimate our income taxes for each of the jurisdictions in which we operate. We include differences between book and tax basis financial statements as deferred tax assets, such as net operating loss carry forwards, and deferred tax liabilities in our consolidated balance sheet. We then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent we believe that recovery is not likely, we establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in any period, we include an expense within the tax provision in our

statement of operations.

In the United States, prior to 2007, we had a history of losses and, as a result, have historically provided for a valuation allowance for net deferred tax assets. Each quarter, we evaluate the need to retain all or a portion of the valuation allowance on its net deferred tax assets. During 2010, we determined that it was more likely than not that the deferred tax assets, including NOLs, would be realized, and as a result, released $12,833 of the valuation allowance. In making this determination, we analyzed, among other things, our recent history of earnings, our cumulative earnings for the last 12 quarters, and forecasts of future earnings. The reversal of the valuation allowance resulted in an income tax benefit of $4,535 for the year ended December 31, 2010, and an increase in the current and non-current deferred tax assets on the consolidated balance sheet as of December 31, 2010.

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Significant management judgment is required in determining our provisions for income taxes, our deferred tax assets and liabilities and our future taxable income for purposes of assessing our ability to utilize any future tax benefit from our deferred tax assets. If actual results differ from these estimates or we adjust these estimates in future periods, our financial position, cash flows and results of operations could be materially affected.

Liabilities are recorded for more likely than not income tax assessments based on estimates of potential tax related exposures, and utilizes a recognition threshold and measurement approach for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Differences between actual results and assumptions, or changes in assumptions in future periods, are recognized in the period they become known.

Recently issued accounting pronouncements

Since December 31, 2010, there are no recently issued accounting standards that are expected to have a material effect on our financial condition, results of operations or cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to the impact of interest rate changes, foreign currency fluctuations, and changes in the market values of our investments.

Financing Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our line of credit which bears an interest rate equal to 0.75% above the prime rate or 3.5% above LIBOR (which was 3.80% at December 31, 2010) and is calculated based on amounts borrowed under the facility. In addition, one of our German loans had its interest rate reset to 5.73%, the prevailing market rate in 2009. Fluctuations or changes in interest rates may adversely affect our expected interest expense. The effect of a 10% adverse fluctuation in the interest rate on our line of credit and bank loans would have had an effect of approximately $30 on our interest expense for 2010.

Investment Risk

We invest our excess cash in select money market accounts and certificates of deposit and, by practice, limit the amount of exposure to any one institution. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely affected due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. The effect of a 10% fluctuation in the interest rate of any of our floating rate securities would not be material for 2010.

Foreign Currency Risk

International revenues (primarily defined as sales to customers located outside of the United States) accounted for approximately 84% of our total sales in 2010. Approximately 43% of our international revenues were denominated in Euros, relating to shipments from our Dresden facility in 2010. The other 41% of our international revenues were denominated in U.S. dollars. In addition, certain transactions with foreign suppliers are denominated in foreign currencies. The effect of a 10% fluctuation in the Euro exchange rate would have had an effect of approximately $1,922 on net revenues and $1,802 on expenses for 2010 and the effect on expenses of a 10% fluctuation in the Yen exchange rate would have had an effect of approximately $316 on expenses for 2010.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Southwall Technologies Inc.

We have audited the accompanying consolidated balance sheet of Southwall Technologies Inc. and subsidiaries (collectively, the “Company”) as of December 31, 2010, and the related consolidated statement of operations, stockholders' equity, and cash flows for the year then ended. Our audit also included the financial statement schedule of Southwall Technologies Inc. and subsidiaries listed in Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southwall Technologies Inc. and subsidiaries as of December 31, 2010, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ SingerLewak LLP
San Jose, California
March 28, 2011

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Southwall Technologies Inc.

We have audited the accompanying consolidated balance sheet of Southwall Technologies Inc. and its subsidiaries (collectively, the “Company”) as of December 31, 2009 and the related consolidated statements of operations, stockholders’ equity and cash flows for each of the two years in the period ended December 31, 2009. Our audits also included the financial statement schedule for each of the two years in the period ended December 31, 2009, listed in the Index at Item 15(a)(2). These consolidated financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor have we been engaged to perform, an audit of the Company’s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southwall Technologies Inc. and its subsidiaries as of December 31, 2009 and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Burr Pilger Mayer, Inc.
San Jose, California
March 24, 2010

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SOUTHWALL TECHNOLOGIES INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	December 31, 2010	2009
ASSETS		
Current assets:		
Cash and cash equivalents	$13,776	$12,454
Accounts receivable, net of allowances for sales returns and doubtful accounts of $1,316 and $722 in 2010 and 2009, respectively	5,902	5,300
Inventories, net	5,536	4,522
Prepaid income taxes	2,017	-
Other current assets	1,901	1,479
Total current assets	29,132	23,755
Property, plant and equipment, net	15,235	14,393
Goodwill	1,854	-
Intangible assets	901	-
Deferred tax and other assets	3,468	156
Total assets	$50,590	$38,304
LIABILITIES, PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long term debt and capital lease obligations	$1,024	$808
Accounts payable	2,628	1,258
Accrued compensation	1,742	1,395
Other accrued liabilities	4,764	4,274
Total current liabilities	10,158	7,735
Term debt and capital lease obligations	3,511	3,358
Other long term liabilities	112	58
Total liabilities	13,781	11,151
Commitments and contingencies (Notes 5 and 9)		
Series A convertible preferred stock, $0.001 par value;		
5,000 shares authorized, 4,893 shares outstanding at December 31, 2010 and 2009 (Liquidation preference: $7,745 and $7,255 at 2010 and 2009, respectively)	4,810	4,810
Southwall stockholders' equity:		
Common stock, $0.001 par value; 10,000 and 50,000 shares authorized, and 5,799 and 28,791 shares outstanding at December 31, 2010 and 2009, respectively	29	29
Capital in excess of par value	78,759	78,291
Accumulated other comprehensive income	3,466	4,382
Accumulated deficit	(50,228)	(60,359)
Total Southwall stockholders' equity	32,026	22,343
Noncontrolling interest	(27)	-
Total equity	31,999	22,343
Total liabilities, preferred stock and stockholders’ equity	$50,590	$38,304

(1) All common share amounts (except par value and par value per share amounts) have been retroactively restated for December 31, 2010 to reflect the Company’s 1-for-5 reverse stock split of its common stock described in Note

1 to these consolidated financial statements.

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

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SOUTHWALL TECHNOLOGIES INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Years Ended December 31,		
	2010	2009	2008
Net revenues	$ 45,017	$ 32,103	$ 41,920
Cost of revenues	24,962	17,704	24,378
Gross profit	20,055	14,399	17,542
Operating expenses (income):			
Research and development	3,733	2,874	2,996
Selling, general and administrative	10,010	8,037	8,199
Restructuring (recoveries) expenses, net	-	(56)	-
Total operating expenses	13,743	10,855	11,195
Income from operations	6,312	3,544	6,347
Interest expense, net	(295)	(570)	(586)
Other income (expense), net	102	2,844	(62)
Income before provision for (benefit from) income taxes	6,119	5,818	5,699
Provision for (benefit from) incomes taxes	(3,678)	154	511
Net income	9,797	5,664	5,188
Net loss attributable to noncontrolling interest	(334)	-	-
Net income attributable to Southwall	10,131	5,664	5,188
Deemed dividend on preferred stock	489	489	489
Net income attributable to common stockholders	$ 9,642	$ 5,175	$ 4,699
Net income per share (1):			
Basic	$ 1.67	$ 0.90	$ 0.83
Diluted	$ 1.39	$ 0.82	$ 0.76
Weighted average shares used in computing net income per share (1):			
Basic	5,769	5,746	5,650
Diluted	7,274	6,897	6,852

(1) All share and per share amounts have been retroactively restated for all periods presented to reflect the Company’s 1-for-5 reverse stock split described in Note 1 to these consolidated financial statements.

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

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SOUTHWALL TECHNOLOGIES INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)

	Common Stock							
	Number of Shares	Par Value	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Southwall Stockholders' Equity	Non-controlling Interests	Total
Balance December 31, 2007	27,820	$28	$78,290	$ (71,211)	$ 4,776	$ 11,883	$ -	$11,883
Net income				5,188		5,188		5,188
Cumulative translation adjustment					(507)	(507)		(507)
Comprehensive income						4,681	-	4,681
Issuance of shares on stock option and warrant exercises	887	1	303			304		304
Dividend accrual on Series A Preferred Stock			(489)			(489)		(489)
Stock-based compensation expense			219			219		219
Balance December 31, 2008	28,707	29	78,323	(66,023)	4,269	16,598	-	16,598
Net income				5,664		5,664		5,664
Cumulative translation adjustment					113	113		113
Comprehensive income						5,777	-	5,777
Issuance of shares on stock option exercises	84		54			54		54
Dividend accrual on Series A Preferred Stock			(489)			(489)		(489)
Stock-based compensation expense			403			403		403
Balance December 31, 2009	28,791	29	78,291	(60,359)	4,382	22,343	-	22,343
Net income				10,131		10,131	(334)	9,797
					(5)	(5)		(5)

Net unrealized loss on cash flow hedge								
Cumulative translation adjustment					(911)	(911)		(911)
Comprehensive income						9,215	(334)	8,881
Issuance of shares on stock option exercises	41		273			273		273
Acquisition of controlling interest in SIG							346	346
Purchase of noncontrolling interest in SIG			39			39	(39)	-
Dividend accrual on Series A Preferred Stock			(489)			(489)		(489)
Net excess tax benefits from stock options			17			17		17
Stock-based compensation expense			628			628		628
Adjustment for 1-for-5 reverse stock split	(23,033)							
Balance December 31, 2010	5,799	$29	$78,759	$ (50,228)	$ 3,466	$ 32,026	$ (27)	$31,999

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

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SOUTHWALL TECHNOLOGIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years Ended December 31,		
	2010	2009	2008
Cash flows from operating activities:			
Net income	$ 9,797	$ 5,664	$ 5,188
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on acquisition of controlling interest in Southwall Insulating Glass, LLC (“SIG”)	(706)	-	-
Gain on settlement of liability	-	(2,359)	-
Deferred income tax	(4,414)	(38)	38
Net excess tax benefits from stock options	(17)	-	-
(Gain) loss on disposal of property, plant and equipment	33	(4)	97
Depreciation and amortization	2,813	2,596	2,647
Stock-based compensation expense	628	403	219
(Provision for) recovery of inventory reserves	(300)	107	(428)
(Provision for) recovery of returns and allowance reserves	594	(784)	338
Non-cash effect of acquisition of controlling interest in SIG	(232)	-	-
Changes in operating assets and liabilities:			
Accounts receivable	657	(2,230)	530
Inventories	(622)	1,354	103
Other current and non-current assets	(2,030)	(20)	601
Accounts payable and accrued liabilities	(595)	539	(2,233)
Net cash provided by operating activities	5,606	5,228	7,100
Cash flows from investing activities:			
Acquisition of assets of Crown Operations International	(3,302)	-	-
Acquisition of controlling interest in SIG, net of cash acquired	(195)	-	-
Restricted cash	-	261	1,189
Proceeds from sale of property, plant and equipment	-	34	-
Expenditures for property, plant and equipment and other assets	(1,888)	(1,725)	(626)
Net cash provided by (used in) investing activities	(5,385)	(1,430)	563
Cash flows from financing activities:			
Principal payments on term debt and capital lease obligations	(921)	(2,242)	(3,551)
Borrowings from term loan	1,250	-	-
Investment credit in Germany	379	221	-
Net excess tax benefits from stock options	17	-	-
Proceeds from stock option and warrant exercises	273	54	304
Net cash provided by (used in) financing activities	998	(1,967)	(3,247)
Effect of foreign exchange rate changes on cash	103	(145)	(140)
Net increase in cash and cash equivalents	1,322	1,686	4,276
Cash and cash equivalents, beginning of year	12,454	10,768	6,492
Cash and cash equivalents, end of year	$ 13,776	$ 12,454	$ 10,768
Supplemental cash flow disclosures:			
Interest paid	$ 309	$ 508	$ 730
Income taxes paid	$ 2,412	$ 717	$ 428
Supplemental schedule of non-cash investing and financing activities:			

Dividends accrued	$	489	$	489	$	489
Acquisition of interest in SIG (Note 12)	$	39	$	-	$	-
Abandonment of leased asset and cancellation of lease with Sound Solutions	$	411	$	-	$	-
Deposits through capital leases	$	-	$	-	$	210
Deposits applied to acquisition of property, plant and equipment	$	-	$	210	$	-
Property, plant and equipment acquired through capital leases	$	270	$	88	$	605

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

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SOUTHWALL TECHNOLOGIES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except per share data)

NOTE 1 - THE COMPANY AND A SUMMARY OF ITS SIGNIFICANT ACCOUNTING POLICIES:

The Company

Southwall Technologies Inc. (“Southwall”, “we”, “us”, “our”, and the “Company” refer to Southwall Technologies Inc. and its subsidiaries, Southwall Europe GmbH, Southwall IG Holdings, Inc., Southwall Insulating Glass, LLC (“SIG”) and Crown Operations International, LLC) is a developer, manufacturer and marketer of high performance films and, beginning in 2008, glass products that improves energy efficiency in architectural and automotive glass applications. We have developed a variety of products that control sunlight in automotive glass, reduce light reflection, reduce electromagnetic radiation and improve image quality in electronic display products and conserve energy in architectural products. Our products consist of transparent solar-control films for automotive glass; energy control films for architectural glass; and in the past has included and may include in the future anti-reflective films for computer screens, including flat panel displays, plasma displays, and transparent conductive films for use in touch screen and liquid crystal displays; and various other coatings.

Reverse Stock Split

On March 9, 2011, the Company completed a 1-for-5 reverse stock split of its common stock, pursuant to previously obtained stockholder approval on May 12, 2010. The reverse stock split reduced the number of shares of the Company’s common stock issued and outstanding from approximately 28.8 million to approximately 5.8 million. In connection with the reverse stock split, the Company also reduced the number of our authorized shares of common stock from 50 million to 10 million to reflect the reverse stock split ratio. All share and per share amounts herein are presented on a post-reverse stock split basis, other than the consolidated balance sheet at December 31, 2009 and the consolidated statements of stockholders’ equity for the years ended December 31, 2007 through December 31, 2009.

Principles of consolidation

The consolidated financial statements include the accounts of Southwall, its wholly-owned subsidiaries and its controlled majority-owned subsidiary. All inter-company balances and transactions have been eliminated in consolidation.

Reclassifications

Certain reclassifications have been made to the prior year's consolidated balance sheets and statements of cash flows to conform to the current year presentation.

Foreign currency translation

The Company's German subsidiary uses the Euro as its functional currency. Accordingly, the financial statements of this subsidiary are translated into U.S. dollars in accordance with Accounting Standards Codification (“ASC”) 830, Foreign Currency Matters (“ASC 830”). Assets and liabilities are translated at exchange rates in effect at the balance sheet date and revenue and expense accounts at average exchange rates during the period. Exchange gains or (losses) from the translation of assets and liabilities for the years ended December 31, 2010 and 2009 were $(911) and $113, respectively, and are included in the cumulative translation adjustment component of accumulated other comprehensive income (loss). Gains and (losses) arising from transactions denominated in currencies other than the

functional currency were ($333), $134 and $29 in 2010, 2009 and 2008, respectively, and are included in other income (expense), net.

Management estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates included in preparing our consolidated financial statements include: allowance for doubtful accounts and sales returns, the accrual for warranties, income taxes, inventory valuations (including reserves for excess and obsolete and impaired inventories), stock-based compensation, and reserves for decommissioning costs associated with leasehold asset retirement obligations. Actual results could differ from those estimates.

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Cash and cash equivalents

The Company considers all investment securities with an original maturity of three months or less from the date of purchase to be cash equivalents.

Revenue recognition

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectability is reasonably assured. Accordingly, we generally recognize revenue from product sales when the terms of sale transfer title and risk of loss, which occurs either upon shipment or upon receipt by customers, net of any sales, use, value added or certain excise taxes imposed by governmental authorities. In connection with product sales, we make allowances for estimated returns and warranties. We adjust these allowances periodically to reflect our actual and anticipated experience. If any of these conditions to recognize revenue is not met, we defer revenue recognition.

Shipping and Handling Costs

Costs related to shipping and handling are included in cost of revenues.

Accounts receivable and allowances for doubtful accounts

Accounts receivable are recorded at the invoiced amount and are not interest bearing. We establish allowances for doubtful accounts for specifically identified, as well as anticipated, doubtful accounts based on credit profiles of our customers, current economic trends, contractual terms and conditions, and historical payment.

Reserve for sales returns

We establish allowances for sales returns for specifically identified product quality claims as well as estimated potential future claims based on our sales returns and claims experience. We offer ten-year, five-year and less than one year quality claim periods for our products. These amounts are included in accounts receivable, net, in the accompanying consolidated balance sheets.

Concentrations of risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents and trade accounts receivable.

The Company invests in selected financial instruments such as different types of money market funds and certificates of deposit. By policy, the Company limits the amount of credit exposure to any one financial institution or commercial issuer. For U.S. funds, the Company had $10,990 in cash equivalents at December 31, 2010, the majority of which is covered by the U.S. Treasury’s Money Market Guarantee Program or held in certificates of deposit which are FDIC insured up to $250. The Company also had approximately $2,391 in foreign banks or foreign currency denominated accounts at December 31, 2010.

The Company sells its products throughout the world. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers. The Company maintains an allowance for doubtful accounts based upon anticipated collectability of all accounts receivable.

The Company’s four largest customers accounted for approximately 76% of its net revenues in 2010 and the Company’s seven largest customers accounted for 69% and 74% of its net revenues in 2009 and 2008, respectively. During 2010, Solutia, Pilkington PLC and Saint Gobain Sekurit accounted for 38%, 16% and 12%, respectively, of the Company's net revenues. During 2009, Solutia, Pilkington PLC, Saint Gobain Sekurit and Guardian accounted for 24%, 20%, 11% and 10%, respectively, of the Company's net revenues. During 2008, Solutia, Pilkington PLC, and Saint Gobain Sekurit accounted for 33%, 16%, and 13%, respectively, of the Company's net revenues.

The Company expects to continue to derive a significant portion of its net film revenues from a relatively small number of customers. Accordingly, the loss of a large customer could materially hurt the Company's business, and the deferral or loss of anticipated orders from a small number of customers could materially reduce our revenue, operating results and cash flows in any period.

At December 31, 2010, accounts receivable from four customers represented 40%, 20%, 11% and 11% of the Company’s total accounts receivable. At December 31, 2009, accounts receivable from four customers represented 32%, 23%, 12% and 12% of the Company's total accounts receivable.

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The Company manufactures its products using materials procured from third-party suppliers. The Company obtains certain of these materials from limited sources. For example, the substrate the Company uses in the manufacture of its Heat Mirror products is currently available from one main qualified source. The loss of the Company's current source of supply would adversely affect its ability to meet its scheduled product deliveries to customers. Alternative sources of supply are being pursued; however, it takes approximately 18 to 24 months for the Company to qualify a new supplier and it may not be able to successfully develop such sources.

The Company relies on third-party subcontractors to add properties, primarily adhesives, to some of its products. There are only a limited number of qualified subcontractors that can provide some of the services required by the Company. The loss of a subcontractor could adversely affect the Company's ability to meet its scheduled product deliveries to customers, which could damage the Company's relationships with customers. If the Company's subcontractors do not produce a quality product, the Company's yield will decrease and its margins will be lower.

Furthermore, the Company's production machines are large, complex and difficult to design and produce. It can take up to a year from the time the Company orders a machine until it is delivered. Following delivery, it can take the Company, with the assistance of the manufacturer, up to six additional months to test and prepare the machine for commercial production. There are a limited number of companies that are capable of manufacturing these machines to the Company's specifications. The Company's inability in the future to have new production machines manufactured and prepared for commercial production in a timely manner would have a material adverse effect on its business.

Inventories

Inventories are stated at the lower of standard cost (determined by the average cost method) or market (net realizable value). Standard costs, which approximate actual, include materials, labor and manufacturing overhead. The Company establishes provisions for excess and obsolete inventories to reduce such inventories to their estimated net realizable value. Such provisions are charged to cost of revenues.

Property, plant and equipment

Property, plant and equipment are stated at cost. The Company uses the units-of-production method for calculating depreciation on certain of its production machines and the straight-line method for all other property and equipment. Estimated useful lives of the assets range from five to ten years. On its large-scale production machines for which the units-of-production depreciation method is used, the Company records minimum annual depreciation of at least one-half of the depreciation that would have been recorded utilizing the straight-line depreciation method over a ten-year life. Leasehold improvements are amortized using the term of the related lease or the economic life of the improvements, if shorter. Depreciation of assets acquired under capital lease is included in depreciation expense.

Additions, major improvements and enhancements are included in the asset accounts at cost. Ordinary maintenance and repairs are charged to expense as incurred. Gains or losses from disposal are included in operating expenses in selling, general and administrative expenses. Depreciation and amortization expense related to property and equipment for 2010, 2009 and 2008 was $2,669, $2,596 and $2,647, respectively.

Impairment of long-lived assets

Long-lived assets held and used by the Company are reviewed for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Factors that could trigger an impairment review include the following: (i) significant negative industry or economic trends; (ii) exiting an activity in conjunction with a restructuring of operations; (iii) current, historical or projected losses that demonstrate continuing losses associated with an asset; or (iv) a significant decline in our market capitalization, for an extended period of time, relative to net

book value. When we determine that there is an indicator that the carrying value of long-lived assets may not be recoverable, we measure impairment based on estimates of future cash flows. These estimates include assumptions about future conditions such as future revenues, gross margins, operating expenses within our company, the fair values of certain assets based on appraisals, and industry trends. All long-lived assets to be disposed of are reported at the lower of carrying amount or fair market value, less expected selling costs. No impairment has been incurred during the years ended December 31, 2010, 2009 and 2008.

Intangible Assets

The Company performs a quarterly review of intangible assets to determine if facts and circumstances indicate that the useful life is shorter than it had originally estimated or that the carrying amount of assets may not be recoverable. If such facts and circumstances exist, the Company assesses the recoverability of identified intangible assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairments, if any, are based on the excess of the carrying amount over the fair value of those assets. No impairment was incurred during the year ended December 31, 2010.

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Goodwill

Goodwill represents the cost of business acquisitions in excess of the fair value of identifiable net tangible and intangible assets acquired. Goodwill is allocated to the appropriate reporting unit as reviewed by the Company's chief decision maker responsible for reviewing operating performance and allocating resources. Goodwill is tested annually during the fourth quarter, or when events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. Impairment of goodwill is evaluated using a two step process. First, the fair value of the reporting unit is compared with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired, and thus, the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. No impairment was incurred during the year ended December 31, 2010.

Fair value disclosures of financial instruments

The Company has estimated the fair value amounts of its financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities using available market information and valuation methodologies considered to be appropriate and has determined that the book value of those instruments at December 31, 2010 and 2009 approximates fair value.

Based on borrowing rates currently available to the Company for debt and capital leases with similar terms, the carrying value of our term debt and capital leases approximates fair value.

The Company invests its cash and cash equivalents primarily in money market funds and certificates of deposit. We utilize the market approach to measure fair value of our financial assets.

Cash and cash equivalents are summarized as follows:

	December 31, 2010		
	Fair Value	Book Value	Unrealized Gain, net
Money market funds, Level I	$8,990	$8,990	$-
Certificates of deposit, Level I	2,000	2,000	-
Total cash equivalents	10,990	10,990	-
Cash	2,786	2,786	-
Total cash and cash equivalents	$13,776	$13,776	$-

	December 31, 2009		
	Fair Value	Book Value	Unrealized Gain, net
Money Market Funds, Level I	$8,027	$8,027	$-
Certificates of deposit	1,750	1,750	-
Total cash equivalents	9,777	9,777	-
Cash	2,677	2,677	-
Total cash and cash equivalents	$12,454	$12,454	$-

The Company's financial assets and liabilities are valued using market prices on active markets (Level 1). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving

identical assets. As of December 31, 2010, the Company did not have any Level 2 instrument valuations which were obtained from readily available pricing sources for comparable instruments or any Level 3 instruments without observable market values that would require a high level of judgment to determine fair value.

Research and development expense

Research and development costs are expensed as incurred. Costs included in research and development expense include salaries, outside services, building costs, utilities, administrative expenses and allocated costs

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Comprehensive income (loss)

The Company has adopted the provisions of ASC 220, Comprehensive Income. ASC 220 establishes standards for reporting and display in the financial statements of total net income (loss) and the components of all other non-owner changes in equity, referred to as comprehensive income (loss). Accordingly, the Company has reported the translation gain (loss) from the consolidation of its foreign subsidiary in comprehensive income (loss). Comprehensive income (loss) is included in the statements of stockholders' equity for the years ended December 31, 2010, 2009 and 2008.

Restructuring costs

The Company records restructuring reserves when management has approved a plan to restructure operations and a liability has been incurred in accordance with ASC 420, Exit or Disposal Cost Obligations.

Stock-Based Compensation

The Company accounts for stock-based compensation under the fair value recognition provisions of ASC 718, Compensation – Stock Compensation. Stock-based compensation expense in fiscal 2010, 2009 and 2008 included stock-based compensation expense for all share-based payment awards granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of ASC 718. Stock-based compensation expense for all share-based payment awards granted after January 1, 2006, is based on the grant-date fair value estimated in accordance with the current provisions of ASC 718. ASC 718 requires companies to estimate the fair value of share-based payment awards on the date of grant using an option pricing model. The Company uses the Black-Scholes option pricing model. The portion of the award that is ultimately expected to vest is recognized as compensation expense on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of four years.

Income taxes

The Company accounts for deferred income taxes under the liability approach whereby the expected future tax consequences of temporary differences between the book and tax basis of assets and liabilities are recognized as deferred tax assets and liabilities. A valuation allowance is established for any deferred tax assets for which realization is uncertain. Liabilities are recorded for more likely than not income tax assessments based on estimates of potential tax related exposures, and utilize a recognition threshold and measurement approach for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Differences between actual results and assumptions, or changes in assumptions in future periods, are recognized in the period they become known.

Net income per share

Basic net income per share is computed by dividing net income attributable to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) for the period. Diluted net income per share gives effect to all dilutive common shares potentially outstanding during the period, including stock options, warrants to purchase common stock and convertible preferred stock. Preferred stock dividends are added back to net income attributable to common stockholders since they would not have been accrued if the preferred stock had been converted to common stock at the beginning of the period.

The Company excludes options from the computation of diluted weighted average shares outstanding if the exercise price of the options is greater than the average market price of the shares because the inclusion of these options would be anti-dilutive to earnings per share. Accordingly, at December 31, 2010, 2009, and 2008, respectively, stock

options to purchase 910, 203 and 437 shares at a weighted average price of $5.05, $7.38, and $7.40 per share were excluded from the computation of diluted weighted average shares outstanding.

Tables summarizing net income attributable to common stockholders, for basic and diluted net income per share, and shares outstanding are shown below (in thousands):

	Years Ended December 31,		
	2010	2009	2008
Net income attributable to common stockholders - basic	$ 9,642	$ 5,175	$ 4,699
Add: Deemed dividend on preferred stock	489	489	489
Net income attributable to common stockholders - diluted	$ 10,131	$ 5,664	$ 5,188
Weighted average common shares outstanding-basic (1)	5,769	5,746	5,650
Dilutive effect of warrants	-	-	35
Dilutive effect of Series A preferred shares	978	978	979
Dilutive effect of stock options	527	173	188
Weighted average common shares outstanding – diluted (1)	7,274	6,897	6,852
Basic income per share	$ 1.67	$ 0.90	$ 0.83
Diluted income per share	$ 1.39	$ 0.82	$ 0.76

(1) All share and per share amounts have been retroactively restated for all periods presented to reflect the Company's 1-for-5 reverse stock split described in Note 1 to these consolidated financial statements.

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Recent Accounting Pronouncements

There have been no recently issued accounting standards that are expected to have a material effect on our financial condition, results of operations or cash flows.

NOTE 2 – STOCK-BASED COMPENSATION

The following table sets forth the total stock-based compensation expense resulting from stock options included in the consolidated statements of operations in 2010, 2009 and 2008 (All share and per share information presented gives effect to the 1-for-5 reverse stock split, which occurred on March 9, 2011):

	Years Ended December 31,		
	2010	2009	2008
Cost of revenues	$15	$10	$5
Research and development	107	67	26
Selling, general and administrative	506	326	188
Stock-based compensation expense before income taxes	628	403	219
Income tax benefit	-	-	-
Total	$628	$403	$219

Cash proceeds from the exercise of stock options in 2010, 2009 and 2008 were $273, $54 and $304, respectively. The income tax benefit was realized from stock option exercises was $17, $0 and $0 for 2010, 2009 and 2008, respectively. In accordance with ASC 718, the Company presents excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows.

The Company has a stock-based compensation program that provides its Board of Directors broad discretion in creating employee equity incentives. The Company has granted stock options under various option plans and agreements in the past under the 1997 Stock Incentive Plan and the 1998 Stock Option Plan for employees, board members and consultants. The Board of Directors adopted the 1997 and 1998 Stock Option Plans and the 2007 Long Term Incentive Plan on May 12, 1997, August 6, 1998, and April 30, 2007, respectively. The Compensation Committee of the Board of Directors administers the plans and agreements. The exercise price of options granted under the 1997 and 1998 plans must be at least 85% of the fair market value of the stock at the date of grant. Options granted under the 1998 plan prior to October 2004 generally vested at a rate of 25% per year, are non-transferable and expire over terms not exceeding ten years from the date of grant or three months after the optionee terminates his relationship with the Company. Options granted under the 1997 plan prior to October 2004 generally vested at a rate of 25% per year, are non-transferable and expire over terms not exceeding ten years from the date of grant or eighteen months after the optionee terminates his relationship with the Company. Grants issued from and after October 2004 until April 2006 under both plans vested at a rate of 25% after six months and then evenly monthly thereafter for the remaining 42 months. Grants issued from and after April 2006 under both plans vest at a rate of 25% per year on each anniversary of the grant date. Both the 1997 and 1998 plans have expired and no further grants are made under either of those plans.

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Grants of stock options are made pursuant to the Company's Long Term Incentive Plan (the "2007 Plan"), which was approved by the Company's Board of Directors on April 25, 2007 and by the Company's shareholders on May 24, 2007. The 2007 Plan authorizes the granting of up to 2,000 shares of common stock. Under the terms of the 2007 Plan, the Company can grant both Incentive Stock Options and Nonstatutory Stock Options. Grants issued under the 2007 Plan generally vest and become exercisable at a rate of 25% on each anniversary of the date of grant and become fully vested on the fourth anniversary of the date of grant provided that the participant remains an employee or service provider of the Company or a related company. Each option granted under the 2007 Plan is non-transferable and expires over terms not exceeding ten years from the date of grant or 30 days after an option holder's voluntary termination from the Company. If an option holder's employment is terminated involuntarily for misconduct, the option will terminate immediately and may no longer be exercised. Involuntary termination not for misconduct allows for the option holder to exercise options within a period of three months after such termination of service occurs. The 2007 Plan provides for longer expiration periods for employees who terminate but who were employed with the Company in excess of five years. Pursuant to the provisions set forth in the 2007 Plan, the option expiration will be extended anywhere from three months to one year, dependent upon the employee's years of service. These provisions apply to options that expire as the result of involuntary termination not for misconduct. As of December 31, 2010, there were 1,287 shares of common stock available for grant under the 2007 Plan.

The activity under the option plans, combined, was as follows:

	Options	Weighted-Average Exercise Price
Options outstanding at January 1, 2008	1,042	$ 5.41
Granted	233	4.36
Exercised	(106)	2.87
Cancelled or expired	(208)	9.44
Options outstanding at December 31, 2008	961	$ 4.56
Granted	212	3.21
Exercised	(17)	3.20
Cancelled or expired	(25)	24.52
Options outstanding at December 31, 2009	1,131	$ 3.89
Granted	230	8.20
Exercised	(40)	6.79
Cancelled or expired	(34)	6.93
Options outstanding at December 31, 2010	1,287	$ 4.49

The fair value of stock-based awards was estimated using the Black-Scholes model with the following weighted-average assumptions for 2010, 2009 and 2008:

	2010	2009	2008
Expected life (in years)	5.00	5.17	5.66
Risk-free interest rate	2.36%	2.00%	3.08%
Volatility	103%	108%	81%
Dividend	n/a	n/a	n/a
Weighted-average fair value at grant date	$ 6.28	$ 2.53	$ 2.69

The Company's computation of expected volatility is based on historical volatility. The Company's computation of expected life is based on historical exercise patterns. The interest rate for periods within the expected life of the award

is based on the U.S. Treasury yield in effect at the time of grant. The Company has not issued or declared any dividends on its common stock. Additional information regarding options outstanding, exercisable and expected to vest as of December 31, 2010 is as follows:

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	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2010	1,287	$ 4.49	6.67	$ 7,425
Vested and expected to vest at December 31, 2010	1,163	$ 4.35	6.46	$ 6,871
Exercisable at December 31, 2010	726	$ 3.76	5.41	$ 4,711

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between Southwall's closing stock price on the last trading day of fiscal 2010 and the exercise price, times the number of shares) that would have been received by the option holders had all option holders exercised their options on December 31, 2010. This amount changes based on the fair market value of the Company’s stock. Total intrinsic value of options exercised was $131, $36 and $273 for 2010, 2009 and 2008, respectively. As of December 31, 2010, $1,100 of total unrecognized compensation cost related to stock options, net of forfeitures, was expected to be recognized over a weighted-average period of approximately 2.86 years.

The following table summarizes information about stock options outstanding at December 31, 2010:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 1.90 - $1.90	3	5.82	$ 1.90	3	$ 1.90
$ 2.25 - $2.25	169	6.10	2.25	125	$ 2.25
$ 2.50 - $2.90	173	5.24	2.73	146	$ 2.71
$ 3.00 - $3.55	272	7.33	3.21	138	$ 3.27
$ 3.65 - $4.10	27	4.93	3.68	26	$ 3.68
$ 4.20 - $4.20	200	7.16	4.20	100	$ 4.20
$ 4.40 - $5.05	88	4.19	4.49	76	$ 4.44
$ 5.40 - $6.40	98	5.05	6.04	84	$ 6.08
$ 7.50 - $13.35	257	8.55	8.22	28	$ 8.41
$ 1.90 - $13.35	1,287			726	

NOTE 3 - BALANCE SHEET DETAIL

	December 31,	
	2010	2009
Inventories, net:		
Raw materials	$ 3,072	$ 2,010
Work-in-process	817	1,176
Finished goods	1,647	1,336
	$ 5,536	$ 4,522

	December 31,	
	2010	2009
Property, plant and equipment, net:		
Land, buildings and leasehold improvements	$ 9,453	$ 8,015
Machinery and equipment	33,099	31,539
Furniture and fixtures	2,769	3,986
	45,321	43,540
Less - accumulated depreciation and amortization	(30,086)	(29,147)
	$ 15,235	$ 14,393

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The Company's property, plant and equipment included approximately $1,230 and $999 of assets held under capital leases at December 31, 2010 and 2009, respectively. Accumulated depreciation for assets held under capital lease was $352 and $197 at December 31, 2010 and 2009, respectively.

	December 31,	
	2010	2009
Other Accrued Liabilities:		
Accrued asset retirement obligations	$ 480	$ 480
Accrued dividend payable – Series A Preferred Stock	2,935	2,446
Income tax payable	157	130
Accrued settlement expense	49	300
Accrued accounting and tax fees	193	384
Customer deposits	560	101
Other accrued liabilities	390	433
	$ 4,764	$ 4,274

Restructuring costs.

In December 2002, the Company implemented a reduction in force at its Palo Alto location and elected to vacate certain buildings in Palo Alto. As a result of these actions, the Company incurred a restructuring charge of $2,624 in 2002 related to employee severance packages and the remaining rents due on excess facilities in Palo Alto that the Company no longer occupied. In 2003, the Company recorded a credit to operating expenses of $65 as a result of modifications to the severance packages of certain employees. In 2006, the Company incurred a restructuring charge of $915 related to the closure of the Palo Alto manufacturing facility and the related severance and incentive payout to terminated employees. A manufacturing asset was also decommissioned in 2006. In 2007, the Company reserved an additional $56 for costs associated with its Palo Alto manufacturing facility, which was subsequently reversed in 2009 due to the Company's change in cost estimate related to its Palo Alto manufacturing facility. The balance in the restructuring liability at December 31, 2010 and 2009 was zero.

Indemnification obligations.

The Company's By-Laws require it to indemnify its officers and directors, as well as those who act as directors and officers of other entities, against expenses, judgments, fines, settlements and other amounts actually and reasonably incurred in connection with any proceedings arising out of their services to the Company. The indemnification obligations are more fully described in the Company's By-Laws. The Company purchases insurance to cover claims made against its directors and officers, senior management and certain agents. Since a maximum obligation is not explicitly stated in the Company's By-Laws and will depend on the facts and circumstances that arise out of any future claims, the overall maximum amount of the obligations cannot be reasonably estimated and therefore no liability has been accrued at December 31, 2010. Historically, the Company has not made payments related to these indemnifications.

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As is customary in the Company's industry and as provided for in local law in the U.S. and other jurisdictions, many of the Company's standard contracts provide remedies to customers and other third parties with whom the Company enters into contracts, such as defense, settlement, or payment of judgment for intellectual property claims related to the use of its products. From time to time, the Company indemnifies customers, as well as suppliers, contractors, lessors, lessees, and others with whom it enters into contracts, against combinations of loss, expense, or liability arising from various triggering events related to the sale and the use of the Company's products and services, the use of their goods and services, the use of facilities and state of Company-owned facilities, and other matters covered by such contracts, usually up to a specified maximum amount. In addition, from time to time, the Company sometimes provides protection to these parties against claims related to undiscovered liabilities, additional product liability, or environmental obligations. To date, claims made under such indemnifications have been insignificant, and therefore, no liability has been accrued at December 31, 2010.

NOTE 4 – FINANCING AGREEMENTS/SERIES A PREFERRED STOCK

On December 18, 2003, the Company entered into an investment agreement with Needham & Company, Inc., Needham Capital Partners II, L.P., Needham Capital Partners II (Bermuda), L.P., Needham Capital Partners III, L.P., Needham Capital Partners IIIA, L.P., Needham Capital Partners III (Bermuda), L.P., (together referred to as “Needham Company and its Affiliates”) and Dolphin Direct Equity Partners, L.P. (collectively with Needham Company and its Affiliates, “the Investors”). On December 31, 2004, the Investors elected to convert all outstanding principal of, and accrued but unpaid interest on, their secured convertible promissory notes (“Convertible Notes”) of the Company into shares of the Company’s Series A 10% Cumulative Preferred Stock. The Convertible Notes by their terms were convertible at the option of the holders into Series A Cumulative Preferred Stock at a rate of one share for each $1.00 of principal or interest converted. The aggregate principal amount of the Convertible Notes converted by the Investors was $4,500 and interest accrued thereon as of the time of conversion was $393. The aggregate number of shares of Series A Cumulative Preferred Stock issued as a result of the conversion was 4,893. In particular, Needham Company and its Affiliates received 3,262 shares and Dolphin Direct Equity Partners, L.P. received 1,631 shares.

At December 31, 2010, Needham Company and its Affiliates and Dolphin Direct Equity Partners, L.P., own 39.0% and 16.0%, respectively, of the Company’s outstanding common stock. In addition, if Needham Company and its Affiliates and Dolphin Direct Equity Partners, L.P. had converted Series A shares into common stock at December 31, 2010, they would have owned 43.0% and 18.5%, respectively, of the Company’s outstanding common stock. In each of the years 2010, 2009 and 2008, the Company accrued $489 of deemed dividends on preferred stock with respect to Series A shares. As of December 31, 2010, $2,935 is accrued and included in other accrued liabilities in the accompanying consolidated balance sheet.

Material Terms of the Series A Preferred Shares

Dividends. Each of the Series A shares have a stated value of $1.00 and are entitled to a cumulative dividend of 10% per year, payable at the discretion of the Board of Directors (“Board”). Dividends on the Series A shares accrue daily commencing on the date of issuance and are deemed to accrue whether or not earned or declared and whether or not there are profits, surplus or other funds legally available for the payment of dividends. Accumulated dividends, when and if declared by the Board, will be paid in cash.

Liquidation Preference. Upon a liquidation or dissolution of Southwall, the holders of Series A shares are entitled to be paid a liquidation preference out of assets legally available for distribution to the Company’s stockholders before any payment may be made to the holders of common stock. The liquidation preference is equal to the stated value of the Series A shares, which is $1.00 per share, plus any accumulated but unpaid dividends. Mergers, the sale of all or substantially all of the Company’s assets or the acquisition of Southwall by another entity and certain other similar transactions may be deemed to be liquidation events for these purposes.

Restrictions. So long as any Series A shares are outstanding, unless all accrued dividends on all Series A shares have been paid, the Company is prohibited from taking certain actions, including redeeming or purchasing shares of its common stock and paying dividends on its common stock.

General Voting Rights. Except under certain circumstances or as otherwise provided by law, the holders of Series A shares have no voting rights. The approval of the holders of a majority of the Series A shares voting separately as a class will be required to effect certain corporate actions.

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Conversion. Each of the Series A shares is convertible into common stock at any time at the option of the holder. Each of the Series A shares is convertible into a number of shares of common stock equal to the sum of its stated value divided by the conversion price of the Series A shares. The conversion price of the Series A shares is $5.00 per share and is subject to adjustment in the event of any stock dividend, stock split, reverse stock split or combination affecting such shares. The Series A shares also have anti-dilution protection that adjusts the conversion price downwards using a weighted-average calculation in the event the Company issues certain additional securities at a price per share less than the closing price per share of its common stock on any stock exchange on which its common stock is listed. Each Series A share is initially convertible into one share of common stock. If the closing price of the Company's common stock on any stock exchange on which its common stock is listed is $20.00 or more per share (subject to appropriate adjustment if a stock split, reverse split or similar transaction is affected) for 30 consecutive days, all outstanding Series A shares shall automatically be converted.

Redemption. The Series A shares are not redeemable.

NOTE 5 - INTEREST-BEARING BANK DEBT AND CAPITAL

On May 19, 2008, the Company entered into a Credit Agreement ("2008 Credit Agreement") with Wells Fargo Bank (the "Bank"). The 2008 Credit Agreement provided for a $3,000 revolving line of credit, under which we could, from time to time, borrow up to 85% of eligible accounts receivables. The interest rate on amounts borrowed under the facility was prime plus 0.75% annualized on the average daily financed amount outstanding. All borrowings under the facilities were collateralized by our assets in the United States and were subject to certain covenants including minimum cumulative quarterly net income, minimum net worth and a maximum annual cap on unfinanced capital expenditures. On November 28, 2008, an amendment to the Credit Agreement was executed that adjusted the minimum monthly book net worth covenant effective October 31, 2008. The maturity date of the facility was May 18, 2009.

In June 2009, the Company entered into a new Credit Agreement (the "2009 Credit Agreement") with the Bank. The 2009 Credit Agreement provides for a $3,000 revolving line of credit. The Credit Agreement was renewed in June 2010. Advances under the line exceeding $1,500 will be limited to 80% of eligible accounts receivable. The Company is not eligible for additional borrowings, if the Company's consolidated cash balance falls below $3,500. Amounts borrowed under the facility bear interest at either prime plus 0.75% or LIBOR plus 3.5%, determined at the discretion of the Company, and is annualized on the average daily financed amount outstanding. All borrowings under the facilities are collateralized by the Company's assets in the United States and are subject to certain covenants including minimum quarterly net income and minimum liquid asset requirements. The line of credit expires in June 2011, at which point the Company plans to renew the credit line, although no assurances can be given that the Company will be successful in obtaining a new or replacement credit facility due to restrictive credit markets. The foregoing description does not purport to be a complete statement of the parties' rights and obligations under the 2009 Credit Agreement with the Bank and the transactions contemplated thereby or a complete explanation of material terms thereof. As of December 31, 2010, the Company had no amounts outstanding under the line of credit.

In August 2010, the 2009 Credit Agreement was amended to provide for a $1,250 term loan, which was funded on September 2, 2010. Amounts borrowed under the term loan are payable over 36 months in equal installments and bear interest at a fixed rate of 4.05%. The 2009 Credit Agreement was further amended to provide covenants for tangible net worth and fixed charge coverage ratio.

As of December 31, 2010, the Company's term debt and capital lease obligations consisted of the following:

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Description	Rate		Term Debt Balance at December 31, 2010	Capital Lease Balance at December 31, 2010	Total Debt Balance at December 31, 2010	Due In Next 12 Months	Balance at December 31, 2009
German bank loan dated May 12, 1999 (10 year)	6.13	%	$ -	$ -	$ -	$-	$ 6
German bank loan dated May 28, 1999 (20 year)	5.73	%(1)	2,816	-	2,816	331	3,403
German bank loan dated May 28, 2000 (10 year)	7.15	%	-	-	-	-	254
Wells Fargo Bank dated September 2, 2010 (3 year)	4.05	%(2)	1,146	-	1,146	417	-
Total term debt			3,962	-	3,962	748	3,663
German bank financed lease dated June 1, 2008	7.518	%(3)	-	115	115	88	220
U.S. financing agreement dated May 20, 2008	19.80	%(4)	-	224	224	157	382
Wells Fargo Bank financing agreement dated December 27, 2010	4.47	%(5)	-	296	296	74	-
Total capital leases			-	635	635	319	602
Less interest on capital leases			-	62	62	43	99
Total term debt and capital lease obligations			3,962	573	4,535	1,024	4,166
Less current portion			748	276	1,024	-	808
Total term debt and capital lease obligations, non-current			$ 3,214	$ 297	$ 3,511	$1,024	$ 3,358

(1) Interest rate was reset on September 16, 2009 to 5.73%.

(2) Interest rate is fixed at 4.05% until final repayment in 2010.

(3) Interest rate is fixed at 7.518% until payoff.

(4) Implied interest rate based on a lease rate factor.

(5) Interest rate is fixed at 4.47% until payoff.

Settlement agreement

During 1999, Southwall entered into a master equipment sale-leaseback agreement with a leasing company, Matrix Funding Corporation ("lessor"). The Company was in dispute with the lessor over the interpretation of certain terms of the lease agreement and withheld lease payments due from March 2001 until February 2004. The lessor notified the Company that it considered the Company to be in default and in January 2002 drew down a letter of credit in the amount of $500 that collateralized the Company's obligations. In May 2002, a suit was filed against the Company by an agent of the successor to the lease demanding payment of unpaid lease payments and alleged residual values. In February 2004, the Company entered into a settlement agreement with the agents pursuant to which the Company agreed to pay an aggregate of $2,000 bearing interest at a stepped rate. The settlement required the Company to make an interest payment in 2004, and beginning in 2005, to make quarterly principal payments of between $75 and $125, plus interest payments until 2010. At December 31, 2008, the carrying value of the liability was $3,354. The agreement included a confession of judgment, whereby the Company acknowledged that it would owe damages of $5,900 in the event of payment defaults under the settlement agreement.

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The Company performed an assessment under ASC 470-50 and 470-60, Debt Modifications and Troubled Debt Restructurings by Debtors to assess whether this debt restructuring constituted a troubled debt restructuring. The Company concluded that the debt restructuring was in fact a troubled debt restructuring as the Company was in financial difficulty, and the lessors had granted a concession to the Company, under the definitions of such conditions as set forth in ASC 470-60. The reduction in the amount of the debt indicated that a concession had been granted. ASC 470 requires an assessment of the total future cash payments specified by the new terms of the debt, including principal, interest and contingent payments. If the payments are less than the carrying amount of the payable, the Company should reduce the carrying amount to an amount equal to the total future cash payments specified by the new terms and should recognize a gain on restructuring of payables equal to the amount of the reduction. In its assessment, management factored in the $5,900 confession of judgment as a contingent payment, thereby eliminating any potential gain on restructuring. The carrying value of the debt would remain on the consolidated balance sheet and the liability would be reduced as payments were made, with a potential gain to be recorded at the date of the final payment and the expiry of the confession of judgment. Based on ASC 450, Contingencies, determination, when the Company considers default probable, the liability would be increased to the $5,900 confession of judgment value. The excess of the carrying value over the original $2,000 settlement was $2,354 and was recorded in other long-term liabilities in the consolidated balance sheet. On January 21, 2009, the Company paid $995, which constituted full and final payment of principal and interest on a note, pursuant to the terms of a settlement agreement resulting from the master sale-leaseback agreement. Upon final payment of principal and interest, a formal release of the obligation under the 2004 settlement agreement was obtained from Portfolio Financial Servicing Company, the successor to Matrix Funding Corporation on January 21, 2009, and a gain of $2,359 was recognized in the first quarter of 2009 in other income (expense), net in the accompanying consolidated statements of operations. At December 31, 2010 the balance was zero.

Loans from German Banks

On May 12, 1999, the Company entered into a loan agreement with a German bank that provided for borrowings up to 3,100 Euros ($3,900). Under the terms of this agreement, the funds were used solely for the purpose of capital investment by Southwall's German subsidiary. The term of the loan is for a period of 10 years and the principal is repayable in Euros after the end of one year in 36 quarterly payments. The interest rate on the loan was 6.13% per annum until December 31, 2009. At December 31, 2010, the balance was zero.

On May 28, 1999, the Company entered into a general loan agreement with a German bank. Under the terms of the loan agreement, funds were made available in three tranches, and were used solely for the purpose of capital investment by the Company's German subsidiary. The agreement contains various covenants with which the Company was in compliance at December 31, 2010; the Company is current with respect to all principal and interest payments due under the loan agreement. Under the first tranche, the Company borrowed 2,500 Euros ($3,200) for a term of twenty years beginning on May 28, 1999. The principal is repayable in Euros beginning after ten years in twenty equal, semi-annual payments. The loan bore fixed interest of 7.1% per annum for the first ten years. The interest rate was reset on September 16, 2009 to 5.73%. Of the borrowings outstanding under this tranche of $3,403 at December 31, 2009, $3,045 was classified as non-current in the accompanying consolidated balance sheet. Under the second tranche, the Company borrowed 1,700 Euros ($2,100) for a term of seven years beginning May 28, 1999 and the principal is repayable after one year in twelve equal, semi-annual payments. The loan bore fixed interest at 3.75% per annum for the period of seven years. At December 31, 2009, the amount due under this second tranche was zero. Under the third tranche, the Company borrowed 2,100 Euros ($2,700) for a term of ten years beginning on May 28, 2000, and the principal is repayable after one year, in 36 equal quarterly payments. The loan bears fixed interest of 7.15% per annum until the final payment in 2010. At December 31, 2010, the amount due under this tranche was zero.

The preceding German bank loans are collateralized by the production equipment, building and land owned by the Company's German subsidiary. The dollar equivalent value of the remaining balances for the preceding German bank

loans has been calculated using the Euro exchange rate as of December 31, 2010.

During 2008, the Company entered into capital leases to finance manufacturing related equipment. The German bank financed leases dated June 1, 2008 had an aggregate principal balance of $110 as of December 31, 2010. The leases contain four-year terms, and require monthly payments. On May 20, 2008, the Company entered into a lease agreement with Varilease Finance, Inc. to finance manufacturing equipment for use by Southwall Insulating Glass, LLC. The lease term is 36 months, and each monthly payment is based on a lease rate factor defined in the master lease agreement. As of December 31, 2010, the principal balance of this lease was $193.

On December 27, 2010, the Company entered into a lease agreement with Wells Fargo Bank to finance research and development equipment. The lease term is 48 months and requires monthly payments. As of December 31, 2010, the principal balance of this lease was $270.

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Scheduled principal payments of term debt and capital lease obligations for the next five years and thereafter, are as follows:

	Amount
2011	$ 1,024
2012	904
2013	713
2014	403
2015	331
Thereafter	1,160
Total	$ 4,535

The Company incurred total interest on indebtedness of $304, $402 and $797 in 2010, 2009 and 2008, respectively.

As of December 31, 2010, the Company was in compliance with all of its financial covenants under all its financial instruments.

NOTE 6 - GOVERNMENT GRANTS AND INVESTMENT ALLOWANCES

The Company had an agreement to receive cash grant awards (the "Grant"), which was approved by the Saxony government in May 1999. As of December 31, 2010, the Company had received approximately 5,000 Euros under this Grant since 1999 and accounted for the Grant by applying the proceeds received to reduce the cost of fixed assets of the Dresden, Germany manufacturing facility. The disclosed U.S. dollar amounts are based upon transaction date currency exchange rates.

Giving effect to an amendment of the terms of the Grant in 2002, the Grant was subject to the following requirements:

(a) The grant was earmarked to co-finance the costs of the construction of a facility to manufacture XIR® film for the automotive glass industry;

(b) The construction period for the project was from March 15, 1999 to June 30, 2006;

(c) The total investment during the construction period should be at least 33,728 Euros ($33,883); and

(d) The project must create at least one hundred fifteen permanent jobs and five apprenticeships by June 30, 2006.

The Company believes it met the above requirements at June 30, 2006. The Company reached a settlement with the Saxony government regarding the unused grants, and in October 2007, it repaid 128 Euros ($185) to the Saxony Government consisting of 113 Euros ($163) of prepaid grants with 15 Euros ($22) of corresponding interest.

In addition to the Grant, the Company was further eligible for cash investment allowances from the Saxony government calculated based on the total projected capital investment by the Company in its Dresden facility of 33,728 Euros ($33,883), subject to European Union regulatory approval. During 2000, 2001, 2002, 2003, 2004, 2005 and 2006 the Company received 1,200 Euros ($1,500), 2,500 Euros ($3,200), 1,200 Euros ($1,500), 1,300 Euros ($1,600), 400 Euros ($500), 158 Euros ($190) and 38 Euros ($49), respectively, in investment allowances from the Saxony government, and those proceeds were applied to reduce the capitalized construction cost of the Dresden facility. These investment allowances are subject to the following requirements:

(a) The movable and immovable assets, the acquisition costs of which are taken into account in determining the investment allowance, shall be employed within the subsidized territory for a period of at least five years following the acquisition or production; and

(b) The movable assets, the acquisition costs of which are taken into account in determining the increased investment allowance, shall remain in a business that is engaged in the processing industry, or in a similar production industry, for a period of at least five years following the acquisition or production.

If the Company fails to meet the above requirements, the Saxony government has the right to demand repayment of the allowances. The Grants and investment allowances, if any, that the Company was entitled to seek from the Saxony government vary from year to year based upon the amount of capital expenditures that meet the above requirements. Generally, Southwall is not eligible to seek total investment grants for any year in excess of 33% of its eligible capital expenditures for that year. The Company cannot guarantee that it will be eligible for or receive additional grants or allowances in the future. As of December 31, 2010, the Company was in compliance with the requirements mentioned above. The Company had accrued 150 Euros ($211) in the event that the number of qualified employees did not meet the grant specifications and has included this amount in other accrued liabilities in the consolidated balance sheet at December 31, 2008. The Company received notification from the Saxony Government that, in light of the economic downturn, penalties would not be assessed retroactively if headcount requirements were not met. Upon receipt of such notification, the full amount accrued at December 31, 2008 was reversed in 2009.

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NOTE 7 - INCOME TAXES

The provision for (benefit from) income taxes for the years then ended December 31, 2010, 2009 and 2008 consist of the following:

	Years Ended December 31,		
	2010	2009	2008
Current:			
Federal	$685	$(128)	$49
State	(12)	32	38
Foreign	344	211	392
Total current	1,017	115	479
Deferred:			
Federal	(4,415)	-	-
State	(232)	-	-
Foreign	(48)	39	32
Total deferred	(4,695)	39	32
Total provision for (benefit from) income taxes	$(3,678)	$154	$511

The income tax benefit in 2010 relates primarily to the release of the Company's valuation allowance against deferred taxes. The current tax provision is primarily the federal and foreign taxes.

The effective income tax rate differs from the federal statutory rate as a result of the release of the Company's valuation allowance against deferred taxes and foreign taxes for the year ended December 31, 2010. The effective tax rate reconciliations for the years ended December 31, 2010, 2009 and 2008 are as follows:

	Years Ended December 31,		
	2010	2009	2008
Tax at federal statutory rate	34.0%	34.0%	34.0%
Foreign rate differential	(6.0)%	(4.1)%	(2.6)%
Permanent items	2.6%	1.4%	0.5%
R&D credit	(1.0)%	-%	(0.2)%
Foreign tax credit	(0.8)%	(0.6)%	-%
Decrease in valuation allowance	(91.1)%	(53.2)%	(22.7)%
Dividend from foreign subsidiary	-%	25.1%	-%
Other	2.2%	-%	-%
Provision for (benefit from) income taxes	(60.1)%	2.6%	9.0%

U.S. and foreign components of income before taxes are as follows:

	Years Ended December 31,		
	2010	2009	2008
U.S.	$4,165	$4,379	$4,049
Foreign	1,954	1,439	1,650
Total	$6,119	$5,818	$5,699

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Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets are as follows:

	December 31,	
	2010	2009
Deferred tax assets:		
Federal and state net operating losses	$1,598	$9,592
Research, MIC, and other tax credits	1,321	1,292
Accruals	1,145	1,626
Depreciation and amortization	44	74
Stock-based compensation	307	249
Foreign accruals	185	185
Gross deferred tax assets	4,600	13,018
Deferred tax assets valuation allowance	-	(12,833)
Total deferred tax asset	4,600	185
Deferred tax liabilities:		
Foreign accruals	65	3
Total deferred tax liabilities	65	3
Net deferred tax asset	$4,535	$182

In the United States, prior to 2007, the Company had a history of losses and, as a result, has historically provided for a valuation allowance for net deferred tax assets. Each quarter, the Company evaluates the need to retain all or a portion of the valuation allowance on its net deferred tax assets. During 2010, the Company determined that it was more likely than not that the deferred tax assets, including net operating loss carryforwards ("NOLs"), will be realized, and as a result, released $12,833 of the valuation allowance. In making this determination, the Company analyzed, among other things, its recent history of earnings, its cumulative earnings for the last 12 quarters, and forecasts of future earnings. The reversal of the valuation allowance resulted in an income tax benefit of $4,535 for the year ended December 31, 2010, and an increase in the current and non-current deferred tax assets on the consolidated balance sheet as of December 31, 2010.

The valuation allowance decreased by $12,833 for the year ended December 31, 2010, principally due to the release of the valuation allowance. The valuation allowance decreased by $3,391 for the year ended December 31, 2009 based on the utilization of NOLs for 2009.

During 2010, the Company reviewed its net operating loss carryover limitations as defined in the Internal Revenue Code (IRC) Section 382. An ownership change occurred in 2004, which resulted in an annual limitation of $290 through 2024 for NOLs generated prior to November 2004. As of December 31, 2010, the Company has NOLs for federal income tax purposes of approximately $4,423 (net of the 382 limitation), which expires through 2024. The Company also has California NOLs carryforwards of approximately $3,320, which begin to expire in the year in 2019. During 2008, the State of California suspended the use of NOLs which would have otherwise been utilized in 2008 and 2009. In 2010, the State of California continued to suspend the use of losses through 2011. Accordingly, the carryforward period for these and other California net operating losses have been extended by three years. In addition, the State of California has extended its net operating loss carry forward period from 10 years to 20 years for net operating losses generated in tax years beginning on or after January 1, 2008.

The Company has California research and development tax credit carryforwards of $1,078. The California research credits have no expiration date. The use of the pre November 2004 credits are also subject to an annual limitation

under IRC §383. The calculation is similar to the §382 limitation discussed above. The Company also has a California Manufacturers' Investment Credit ("MIC") carryforward of $55 which will expire between 2011 and 2013.

The Company is indefinitely reinvesting the historic earnings of their foreign subsidiary. If this subsidiary were liquidated, it would not give rise to a material amount of U.S. or foreign tax upon liquidation. The amount of foreign earnings indefinitely reinvested is approximately $6,398 and $4,963 as of December 31, 2010 and 2009 respectively, based on a preliminary study. Accordingly, no U.S. federal tax has been provided on these earnings. Upon distribution of these earnings in the form of dividends or liquidation of the Company's foreign subsidiary, the Company would be subject to U.S. income taxes (after an adjustment for foreign tax credits) of an immaterial amount as of December 31, 2010 and 2009, respectively. This additional income tax may not result in a cash payment to the Internal Revenue Service, but may result in the utilization of deferred tax assets. The additional income taxes that would have resulted, had such earning been distributed are not considered significant.

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The aggregate changes in the balance of gross unrecognized tax benefits were as follows:

	2010
Balance at the beginning of the year	$-
Gross increases — current period tax positions	23
Gross decreases — current period tax positions	-
Gross increases — prior period tax positions	371
Gross decreases — prior period tax positions	-
Balance at the end of the year	$394

The Company's policy is to include interest and penalties related to unrecognized tax benefits with the Company's provision for income taxes. The Company had no accrued interest or penalties related to unrecognized tax benefits as of December 31, 2010.

The Company files federal and state income/franchise tax returns in the U.S. The Company's international subsidiary files income tax returns in Germany. The tax years 1995 through 2010 remain open to U.S. federal income tax examination, and 2000 through 2010 for the Company's state filings. The Company's German subsidiary is open to examination for the years 2005 through 2010.

NOTE 8 - SEGMENT REPORTING

The Company is a developer and manufacturer of high performance films and glass products that improve energy efficiency in architectural and automotive glass applications. Prior to the year ended December 31, 2010, the Company operated only one segment. With the acquisition of the controlling interest in SIG in May 2010, the Company operates in two segments: film, which is a manufacturer of thin film coatings on flexible substrates, and glass, which is a manufacturer of integrated glass units.

The Chief Operating Decision Maker (CODM) is our President and Chief Executive Officer. The CODM allocates resources to and assesses the performance of each operating segment using information about its revenue and operating income (loss).

The Company does not allocate gains and losses from interest and other income, or taxes to operating segments. Although the CODM uses operating income (loss) to evaluate the segments, operating costs included in one segment may benefit the other segment.

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The Company’s net revenues and segment operating income (loss) for the year ended December 31, 2010 and long-lived assets as of December 31, 2010 for each reportable segment are as follows:

	Years Ended December 31,		
	2010	2009	2008
Net revenues:			
Film:			
Automotive	$ 19,898	$ 16,040	$ 19,298
Window	17,178	9,346	15,691
Architectual	5,509	6,353	6,358
Other	389	364	573
Subtotal	42,974	32,103	41,920
Glass	2,043	-	-
Total net revenues	$ 45,017	$ 32,103	$ 41,920