

SOUTHWALL TECHNOLOGIES INC /DE/
Form 10-Q
November 14, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(MARK
ONE)

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

For the quarterly period ended September 30, 2011
or

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 0-15930

SOUTHWALL TECHNOLOGIES INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

94-2551470
(I.R.S. Employer Identification Number)

3788 Fabian Way, Palo Alto, California
(Address of principal executive offices)

94303
(Zip Code)

Registrant's telephone number, including area code: (650) 798-1200

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “large accelerated filer”, “accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check One).

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

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

As of October 25, 2011, there were 5,811,838 shares of the registrant's Common Stock outstanding.

SOUTHWALL TECHNOLOGIES INC.

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PART I. FINANCIAL INFORMATION

Item 1--Financial Statements:

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

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,862	\$ 13,776
Accounts receivable, net of allowances for sales returns and doubtful accounts of \$1,505 at September 30, 2011 and \$1,316 at December 31, 2010	7,888	5,902
Inventories, net	8,183	5,536
Prepaid income taxes	-	2,017
Other current assets	4,108	1,901
Total current assets	33,041	29,132
Property, plant and equipment, net	15,282	15,235
Goodwill	366	1,854
Intangibles assets	346	901
Deferred tax and other assets	3,505	3,468
Total assets	\$ 52,540	\$ 50,590
LIABILITIES, PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 970	\$ 1,024
Accounts payable	3,194	2,628
Accrued compensation	1,619	1,742
Other accrued liabilities	5,124	4,764
Total current liabilities	10,907	10,158
Term debt and capital lease obligations	2,954	3,511
Other long-term liabilities	129	112
Total liabilities	13,990	13,781
Commitments and contingencies (Note 7)		
Series A 10% cumulative convertible preferred stock, \$0.001 par value; \$1.00 stated value; 5,000 shares authorized, 4,893 shares outstanding at September 30, 2011 and December 31, 2010 (liquidation preference: \$8,112 and \$7,745 at September 30, 2011 and December 31, 2010, respectively)	4,810	4,810
Southwall stockholders' equity:		
Common stock, \$0.001 par value per share; 10,000 shares authorized, 5,811 shares outstanding at September 30, 2011 and 5,799 shares outstanding at December 31, 2010	29	29

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Capital in excess of par value	78,957	78,759
Accumulated other comprehensive income	3,787	3,466
Accumulated deficit	(49,033)	(50,228)
Total Southwall stockholders' equity	33,740	32,026
Noncontrolling interest	-	(27)
Total stockholders' equity	33,740	31,999
Total liabilities, preferred stock and stockholders' equity	\$ 52,540	\$ 50,590

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2011	2010	2011	2010
Net revenues	\$13,601	\$ 12,198	\$41,666	\$ 34,469
Cost of revenues	8,015	6,890	24,183	18,549
Gross profit	5,586	5,308	17,483	15,920
Operating expenses:				
Research and development	980	1,024	3,127	2,608
Selling, general and administrative	3,775	2,772	9,651	7,038
Goodwill and intangible assets impairment	-	-	1,833	-
Total operating expenses	4,755	3,796	14,611	9,646
Income from operations	831	1,512	2,872	6,274
Interest expense, net	(60)	(67)	(192)	(225)
Other income (expense), net	(171)	560	166	202
Income before provision for income taxes	600	2,005	2,846	6,251
Provision for income taxes	389	1,057	1,870	959
Net income	211	948	976	5,292
Net loss attributable to noncontrolling interest	-	122	219	152
Net income attributable to Southwall	211	1,070	1,195	5,444
Deemed dividend on preferred stock	122	122	366	366
Net income attributable to common stockholders	\$89	\$ 948	\$829	\$ 5,078
Net income per common share (1):				
Basic	\$0.02	\$ 0.16	\$0.14	\$ 0.88
Diluted	\$0.03	\$ 0.15	\$0.16	\$ 0.75
Weighted average shares used in computing per share amounts (1):				
Basic	5,811	5,768	5,809	5,764
Diluted	7,469	7,267	7,292	7,221

(1)

All share and per share amounts have been retroactively restated for the three and nine months ended September 30, 2010 to reflect the Company's 1-for-5 reverse stock split described in Note 1 to these condensed consolidated financial statements.

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended	
	September 30,	September 30,
	2011	2010
Cash flows from operating activities:		
Net income	\$976	\$ 5,292
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Gain on acquisition of controlling interest in SIG	-	(706)
Deferred income tax	(10)	(1,334)
Loss on disposal of property, plant and equipment	39	10
Depreciation and amortization	2,569	1,989
Goodwill and intangible assets impairment	1,833	-
Stock-based compensation	740	433
Release of inventory reserves	(130)	(201)
Provision for sales returns and doubtful accounts	188	380
Non-cash effect of acquisition of controlling interest in SIG	-	(232)
Changes in operating assets and liabilities:		
Accounts receivable, net	(2,021)	18
Inventories, net	(2,503)	207
Other current and non-current assets	(191)	(240)
Accounts payable and accrued liabilities	525	1,059
Net cash provided by operating activities	2,015	6,675
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)
Acquisition of property, plant and equipment	(2,238)	(1,160)
Net cash used in investing activities	(2,238)	(4,657)
Cash flows from financing activities:		
Proceeds from stock option exercises	71	63
Borrowings from term loan	-	1,250
Repayments of term debt and capital lease obligations	(696)	(599)
Proceeds from investment credit	11	376
Net cash provided by (used in) financing activities	(614)	1,090
Effect of foreign exchange rate changes on cash and cash equivalents	(77)	11
Net increase (decrease) in cash and cash equivalents	(914)	3,119
Cash and cash equivalents, beginning of period	13,776	12,454
Cash and cash equivalents, end of period	\$12,862	\$ 15,573
Supplemental cash flow disclosures:		
Interest paid	\$181	\$ 180

Income taxes paid	\$765	\$ 359
Supplemental schedule of non-cash investing and financing activities:		
Dividends accrued	\$366	\$ 366
Deposits applied to acquisition of property, plant and equipment	\$86	\$ 411
Acquisition of interest in SIG (Note 12)	\$246	\$ 250

See accompanying notes to unaudited condensed consolidated financial statements.

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

Note 1 – Basis of Presentation

Southwall Technologies Inc., including its wholly owned subsidiaries, Southwall Europe GmbH, Southwall IG Holdings, Inc., Southwall Insulating Glass, LLC (“SIG”) and Crown Operations International, LLC, are hereafter referred to as the “Company,” “Southwall,” “Registrant,” “We,” “Our” or “Us.”

The accompanying interim condensed consolidated financial statements of Southwall are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosure normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments considered necessary to present fairly the financial position, results of operations and cash flows of Southwall for all periods presented. The year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. The Company suggests that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Form 10-K for the year ended December 31, 2010 filed with the Securities and Exchange Commission on March 29, 2011. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any future periods.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions, based on all known facts and circumstances that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the periods. Management makes these estimates using the best information available at the time of the estimates. The estimates included in preparing our financial statements include: allowance for doubtful accounts and sales returns, quarterly income taxes, inventory valuations (including reserves for excess and obsolete and impaired inventories), reserves for decommissioning costs associated with leasehold asset retirement obligations, impairment of goodwill and other long-lived assets and the valuation of stock-based compensation. Actual results could differ from those estimates.

Reverse Stock Split

On March 17, 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 for the three and nine months ended September 30, 2010 herein are presented on a post-reverse stock split basis.

Reclassifications

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

Note 2 – Recent 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.

Note 3 – Fair Value Measurements

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 September 30, 2011 approximates fair value.

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

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Southwall invests its cash primarily in money market funds. The Company utilizes the market approach to measure fair value of its financial assets.

Cash and cash equivalents are summarized as follows:

	September 30, 2011		
	Fair Value	Book Value	Unrealized Gain, net
Money market funds, Level I	\$11,153	\$11,153	\$-
Total cash equivalents	11,153	11,153	-
Cash	1,709	1,709	-
Total cash and cash equivalents	\$12,862	\$12,862	\$-

	December 31, 2010		
	Fair Value	Book Value	Unrealized Gain, net
Money Market Funds, Level I	\$8,990	\$8,990	\$-
Certificates of deposit	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	\$-

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 September 30, 2011, 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.

Note 4 – Balance Sheet Detail

	September 30, 2011	December 31, 2010
Inventories, net		
Raw materials	\$ 4,737	\$ 3,072
Work-in-process	1,768	817
Finished goods	1,678	1,647
	\$ 8,183	\$ 5,536
Property, plant and equipment		
Land, buildings and leasehold improvements	\$ 9,750	\$ 9,453
Machinery and equipment	35,565	33,099
Furniture and fixtures	2,937	2,769
	48,252	45,321
Less: accumulated depreciation and amortization	(32,970)	(30,086)
	\$ 15,282	\$ 15,235

Note 5 – Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) attributable to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) for the period. Diluted net income (loss) per common share gives effect to all dilutive common shares potentially outstanding during the period, including stock options and convertible preferred stock. 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 net income (loss) per share. The Company also excludes preferred shares convertible into common stock from the computation of diluted weighted average shares outstanding when the effect would be anti-dilutive.

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At September 30, 2011 and 2010, 175 and 188 outstanding options, respectively, were excluded from the dilutive net income per common share calculation, as they were anti-dilutive because the option prices were higher than the average market price during each of the nine-month periods.

The Company has accrued a deemed dividend on preferred stock of \$122 for each of the three-month periods ended September 30, 2011 and 2010. The dilutive effect of convertible securities shall be reflected in diluted net income (loss) per share by application of the if-converted method. Under this method, if an entity has convertible preferred stock outstanding, the preferred dividends applicable to convertible preferred stock shall be added back to the numerator unless their effect is anti-dilutive.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Net income (loss) attributable to common stockholders - basic	\$89	\$ 948	\$829	\$ 5,078
Add: Deemed dividend on preferred stock	122	122	366	366
Net income (loss) attributable to common stockholders - diluted	\$211	\$ 1,070	\$1,195	\$ 5,444
Weighted average common shares outstanding - basic (1)	5,811	5,768	5,809	5,764
Dilutive effect of Series A preferred shares	978	978		