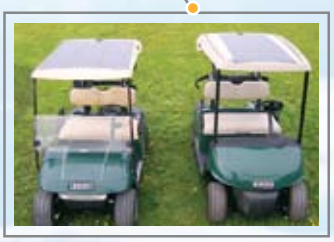
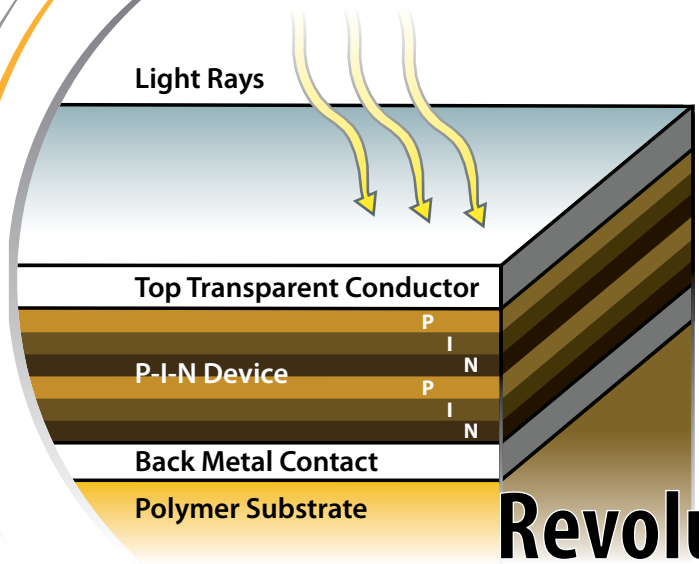
# 2010 ANNUAL REPORT

*KEEP THE POWER ON WITH POWERFILM®*



PowerFilm® SOLAR




Solar Panel Cross Section

PowerFilm SOLAR

## Starts on a roll

13 Inches Wide
Up to 2,400 Feet Long

# Revolutionary Technology

## Proprietary Low Cost Manufacturing Process

PowerFilm has developed a proprietary thin film manufacturing process which consists of roll-to-roll manufacturing of solar cells using an amorphous silicon sunlight absorber layer deposited on a flexible plastic substrate. Individual solar cells are isolated by a laser scribing process. Full panels are formed from the isolated cells through the laser welding interconnects which are printed onto the surface of the material and are encapsulated and combined with various backing materials to create solar panels. The roll-to-roll production line is composed of vacuum deposition, printing, laser scribing, and welding machines custom-designed and assembled by PowerFilm.

**Roll-to-Roll Manufacturing - Low substrate handling costs.** Starts on a roll. Ends on a roll. The resulting roll of solar panels is 13 inches wide and can be up to 2,400 feet long, which brings material handling, during production, closer to that of the printing industry rather than the smaller batch-based approach of rigid crystalline solar panel production. Our company was the first and remains the only company in the world that manufactures and sells solar panels on plastic using a true roll-to-roll manufacturing process.

**Flexible Plastic Substrate - Allows roll-to-roll manufacturing and printed interconnects.** Flexible yet durable polyimide substrate results in enhanced flexibility, paper thinness, and lighter weight. The substrate is as thin as 1 mil (0.025 mm) thick. In addition, the use of an insulating plastic substrate allows for the laser welding of printed interconnects.

**Amorphous Silicon - Low materials costs.** The sunlight absorber layer in PowerFilm solar panels is a low cost, environmentally friendly (cadmium free) and commercially viable technology. The amount of silicon used in the production of PowerFilm's solar panels is as low as 1% of the amount used in rigid crystalline solar panels. Furthermore, PowerFilm extracts the silicon required for its production process from silane gas and is therefore not subject to the silicon wafer supply constraints of the crystalline solar industry.

**Printed Interconnects - Low cost cell connection process.** Laser scribing, printing, and laser welding on-roll enables the automated interconnection of individual solar cells into panels to be carried out in an automated process. Producing 2,400 sq ft of material at a time instead of 4,800 individual cells reduces cost while improving quality and enhancing the durability of PowerFilm solar panels by eliminating the need to cut and connect solar cells manually.

**Encapsulation - Low cost automated process.** PowerFilm solar panels can be encapsulated in a variety of laminate materials to meet the requirements of diverse applications and usage environments. A variety of materials can provide the optimal protection depending on the required product functionality, level and type of protection (moisture / heat / UV), laminate lifetime, and cost. PowerFilm's roll-to-roll manufacturing process using thin plastic film also allows the encapsulation step to be carried out in a roll-to-roll process.

**Bonding and Backing Materials - Low cost installation.** Our company's technology enables the integration of PowerFilm solar panels with several different backing materials including metal, membrane, and architectural fabric. Through our relationships with suppliers, PowerFilm can utilize new materials to produce optimal combinations enhancing product functionality and reducing cost.

## Ends on a roll.

# Table of Contents



A copy of this announcement will be available on the PowerFilm website at www.powerfilmsolar.com.

The common shares of PowerFilm, Inc. are traded on the AIM Market of the London Stock Exchange and are not registered under the US Securities Act 1933, as amended. Such shares may not be offered or sold to residents of the United States or to persons acting on their behalf, or to other persons who are "United States Persons" within the meaning of Regulation S as promulgated under the Securities Act of 1933, unless such shares have been registered under the Securities Act or there is an available exemption from registration.

# Highlights for the Full Year 2010

- Revenue of $10.3 million for the year ended 31 December 2010 (2009: $6.6 million). Top line revenue increased 56% versus a year ago.
- Net Loss of $0.6 million for the year ended 31 December 2010 (2009: $1.9 million). Losses were trimmed significantly versus a year ago to position the Company well to return to profitability in 2011.
- As of 31 December 2010, the Company had $18 million in cash and cash equivalents, restricted cash, and cash and short-term investments held for property and equipment construction (2009: $17.3 million). The Company continues to be in a strong cash position.
- Gross margin for the year ended 31 December 2010 was 9.7% (2009: -5%). Further improvements are projected for 2011.
- The increase in revenue for the year 2010 was the result of both new customers from a diverse range of industries, as well as existing customers increasing their orders. In particular, the product sales revenue increase was aided by the post-recession return of large volume OEM customers and especially strong foldable solar charger sales.
- Development contract revenue also increased in 2010, with both base level of funding for the flexible display technology increasing, as well as the addition of two U.S. federal government economic stimulus contracts.
- As was previously announced in the first half results, PowerFilm has successfully completed the engineering modifications to the meter-wide manufacturing equipment to realize a yield level acceptable for manufacturing of commercial product. The transition process for operation of the equipment from research and development and engineering to manufacturing operations is well underway. Commercial product is now being sold from the meter-wide equipment.
- For building integrated photovoltaics (BIPV), PowerFilm has customized its core products to meet the specific needs of our building integrated strategic partners and markets, beginning with panels to be integrated with architectural fabric and metal roofing. Those panels have been submitted to a third-party test lab for certification to IEC and UL standards.
- The Company continues its collaboration with Ferrari Textiles for launching a truly integrated product and system for the architectural fabric market. Ferrari is a global fabric company well established with the architectural community throughout the world.
- In 2010, as previously announced, the Company was awarded additional funding in the amount of $2.68 million by the U.S. Army in a cooperative agreement for further development of a "Self Powered Flexible Display."

"We are making good progress at creating a sales culture at PowerFilm to grow sales revenue significantly. Our partnering and total solar solutions approach gives us a good position to succeed in our diverse target markets," said Tim Neugent, PowerFilm's President and COO.

Frank Jeffrey, Co-Founder and CEO of PowerFilm, added, "In 2010, the economy turned around and so did PowerFilm. We increased revenue and came close to realizing positive net income again, which is an important goal for PowerFilm. Achieving the meter-wide manufacturing milestone was especially gratifying, and important for the Company's ability to maintain its technology lead, to grow systematically through the next few years, and to become a leading profitable PV company in the next phase of the solar industry."

**For further information, please contact:** PowerFilm + 1 515 292 7606, ext. 102
Frank Jeffrey, Chief Executive Officer
Mike Coon, VP, Building Integrated, Business Development, and External Relations

Nomura Code Securities Limited + 44 20 7776 1200
Juliet Thompson, Giles Balleny

# Chairman and CEO's Statement

2010 was a turnaround year for PowerFilm. With the recovery from the global recession, existing customers increased their purchases and new customers added to sales revenue. Also, 2010 was a strong year for development contract revenues with both funding for the solar-powered flexible display program increasing and the addition of two economic recovery stimulus contracts. We are pleased with this top line revenue growth.

Gross margins improved but are still much below levels we believe are attainable with higher sales volumes and the corresponding economies with high capacity utilization. Our material requirements planning (MRP) system implementation, ever-increasing emphasis on lean manufacturing, and optimized inventory levels are expected to be strong tools to help drive unnecessary costs out of our manufacturing operations. We have managed to avoid the issue of excessive levels of product inventory which have plagued some in the industry.

The Company's strategy of offering differentiated products and total power solutions, working with and through strategic partners, and having diversified target markets yielded good results in 2010.

We will be augmenting our OEM, military, and solar charger sales with a similar targeted approach from this year onwards in the building integrated market, beginning with the architectural fabric product developed with Ferrari Textiles.

Achieving technical success with the meter-wide manufacturing equipment is a major element of our program to reduce manufacturing costs, both relative to our prior process and to our competitive position in the industry. Achieving third-party certification for the building integrated product remains as the top priority of our technology development program.

We made progress with our bottom line versus a year ago, yet we are disappointed that we were not profitable in 2010. With the revenue momentum we have, the economies available from increased product sales volumes, with tighter manufacturing management, and with a close eye on sales, general, and administrative expenses we are confident we are on that track.

We believe the current market valuation of PowerFilm, currently valued at less than the total cash on our balance sheet, significantly undervalues the Company.

Merlin Hanson – Chairman
Frank R. Jeffrey – CEO

# Operational Review

## Meter-Wide Technology

In recent years PowerFilm has been manufacturing with 13 inch-wide manufacturing equipment. It has been developing meter-wide manufacturing equipment to reduce manufacturing costs further. As was previously announced, PowerFilm has successfully completed the engineering modifications to the meter-wide manufacturing equipment to realize a yield level acceptable for manufacturing of commercial product. The transition of the operation of the equipment from research and development and engineering to manufacturing operations is well underway.

The Company's increased use of the meter-wide technology over the upcoming 12-18 months is expected to reduce costs materially, thereby enhancing gross margins. At the 20-25 megawatt scale, the meter-wide manufacturing equipment has the potential to reduce direct manufacturing costs to the $1/Watt range assuming that encapsulation material costs for the entire solar industry will be significantly reduced as industry volumes increase.

## Building Integrated Photovoltaics (BIPV)

For building integrated photovoltaics (BIPV), PowerFilm has customized its core products to meet the specific needs of our building integrated strategic partners and markets, beginning with panels to be integrated with architectural fabric and metal roofing. Those panels have been submitted to a third-party test lab for certification to IEC and UL standards.

PowerFilm's building integrated commercial strategy and plans are to offer differentiated products to the market, generally with established strategic partners in building materials. The initial building integrated market segment is architectural fabric, in which PowerFilm has a competitive advantage with its lightweight, durable product. For this market segment, PowerFilm continues its collaboration with Ferrari Textiles for launching a truly integrated product and system. Ferrari is a global fabric company well established with the architectural community throughout the world.

Also, PowerFilm is working together with Kwang Myung Electric Engineering Company of South Korea and Takashima of Japan for developing and marketing building integrated products for the South Korean and Japanese markets, respectively, and for distributing other products in the PowerFilm product line.

## OEM

Original equipment manufacturer (OEM) companies have diverse, growing, and high volume needs for portable and remote power solutions to meet their specific power requirements.

For many years PowerFilm has been the one of the global leaders in engineering and supplying custom OEM solar panels and total power solutions to diverse markets, each with significant volume potential. The Company's mass customization of solar panels has resulted in a diversified mix of well established revenue streams for PowerFilm. One example is the market for solar recharging of remote oil and gas exploration seismic data collection systems, where PowerFilm received a $1.3 million purchase order contract for its solar panels from a returning customer in 2010.

Other customers come from the OEM markets for golf cart recharging, police and emergency vehicles, multiple lighting applications, and marine applications.

Important commercial relationships such as the Company's relationship with W.W. Grainger, the leading industrial supply company, significantly strengthen PowerFilm's ability to grow sales revenue in the OEM market.

# Operational Review - cont.

## Military

The U.S. military and its allies have a growing need for rugged, lightweight, portable, and remote power to meet a wide range of power needs for today's electronics-intensive warfare. PowerFilm's products allow the military to reduce equipment weight of soldiers, costly fuel consumption, and the requirement to run long logistical tails for fuel convoys. PowerFilm products also support military energy security goals by providing a power source which is an alternative to the primary electrical grid.

Solutions for reducing the monetary and human costs of a long logistical tail for fuel for generators are of clear interest at many levels in the U.S. Department of Defense (DoD), from top officials at the Pentagon to deployed soldiers at remote bases such as those in Afghanistan. Reducing the use of costly fuel for generators in remote areas will help decrease the cost of extended remote deployments and will also decrease convoys and the risk of casualties with those convoys. Reducing the quantity of batteries needed in the field is also of interest. The use of PowerFilm solar panels helps address all of these issues.

PowerFilm develops and supplies its rugged, lightweight solar panels directly to the U.S. military and its military allies. The Company also sells products to defense contractors to add solar power recharging capabilities to their systems. Increasingly, PowerFilm is being called upon to develop and deliver subsystems using its in-house engineering expertise in customized power charging electronics. Therefore, the Company is placing a growing emphasis on providing power solutions that include not only solar panels with an optimized power output and form factor but also balance of systems technology (inverters and batteries) that meet specific military power needs as standalone units, multiple units connected together, or as part of overall hybrid power systems.

To increase PowerFilm's military sales revenues and build upon the Company's many years of military product development and product sales, PowerFilm has hired Wes White as Director of Military Sales. His role is focused on the inclusion of PowerFilm products as a part of hybrid power systems in an ongoing Department of Defense acquisition program that is a program of record. Wes comes to PowerFilm with a strong background in Pentagon acquisition programs.

In 2010, PowerFilm continued with its military product development program for developing a lightweight, portable balance of system/microgrid to provide a versatile and reliable source of electrical power without adding excessive weight to the soldier's load. The combined battery charger/AC solar module has been developed so that a soldier can carry and utilize the output from various power sources in order to generate a low power 120 volt AC output. Additionally, a battery cradle was developed that holds multiple batteries and is capable of generating a higher output level of AC power of approximately one kilowatt.

The microgrid will allow the soldier to directly recharge military BB2590 and BB30 batteries, charge other military equipment via the DC bus or via AC inverter output, and also provide direct AC power for smaller electrical loads. This will reduce the number of batteries soldiers are required to carry (less weight and volume), provide a flexible capability to charge military batteries and other military devices in situ, and remove the need for a small generator and fuel that is typically required for remote power generation for these tasks.

In addition, the Company had another contract with the DoD for continued performance improvement in flexible amorphous silicon photovoltaics. This contract covered support for the Army's needs for solar power-integrated Tentage, Fabric Structures, and Wall Shelters. The purpose of this contract was to further develop a flexible, thin film photovoltaic material on plastic film that can be incorporated into the skins of military tents and into the BB2590 / BB330 battery charging systems.

The built-in ruggedness of PowerFilm solar panels is especially important for use by the military. PowerFilm solar panels continue to perform even after they are damaged with bullets, because PowerFilm's proprietary printed interconnect is a massively parallel interconnect that safeguards the connections between cells.

Unlike copper indium gallium selenide (CIGS) technology, PowerFilm solar panels do not require light-soaking when removed from storage in order to make the panel useful. This ability for soldiers to use PowerFilm solar panels directly from storage in a rucksack, vehicle, or tent is an important technical and practical advantage in remote areas of deployment.

# Operational Review - cont.

## Solar Chargers

PowerFilm sells a full line of solar chargers that are finished products easily used by consumers. The products range from the PowerFilm Solar USB+AA Charger, AA/AAA charger, to rollable and foldable chargers available in several different sizes. The products are distributed via leading national outdoor products retailers REI and West Marine, among others.

These chargers also have strong appeal to the disaster relief market. The Company donated and supplied its solar chargers to the earthquake and tsunami disaster in Japan and other areas.

## Thin Film Electronics Update

PowerFilm, Inc., through its majority-owned subsidiary Phicot, Inc., continues its leading technology position in the development of backplane drivers for flexible displays. In 2010, the Company was awarded third-year funding in the amount of $2.68 million by the U.S. Army in a cooperative agreement for the continued development of a "Self Powered Flexible Display." The self (solar-powered) flexible display device will be for individual soldiers to use to improve their situational awareness. The development of a flexible display under this agreement is expected to have significant crossover benefit in other applications and markets.

The current focus of the program is work on improving initial prototype units and advance plans for a pilot production facility.

**Flexible Display Project Background Information**
PowerFilm is leveraging its expertise in roll-to-roll semiconductor manufacturing with a flexible plastic substrate to produce thin film electronics. The Company is advancing its development program for backplane drivers for flexible displays through its majority-owned subsidiary Phicot, Inc. Collaboration on this project with Hewlett-Packard (HP) continues.
As was previously announced, PowerFilm has licensed self-aligning imprint lithography technology from HP to augment PowerFilm's core technology for the development of low-cost truly roll-manufactured backplane drivers on a thin, flexible plastic substrate.

This funding is part of the cooperative agreement among PowerFilm, HP, and the U.S. Army Research Laboratory (ARL) for the three-year development program that was announced on 06 October 2008. At that time the initial funding award of $1.4 million for the first year was announced.

As was previously announced in August 2009, the Company announced that it had been awarded second year funding in the amount of $1.375 million by the U.S. Army in a cooperative agreement for further development of a "Self Powered Flexible Display."

# Operational Review - cont.

## Notes on PowerFilm Technology

The thorough technology evaluation and choices that PowerFilm made in the early days of the company are withstanding the test of time as well as the competition. PowerFilm's technology choices – highlighted in the table below – enable both differentiated low-cost mass customization of products and low-cost industrial scale manufacturing.

| | **Criteria** | **PowerFilm Selection** |
|---|---|---|
| **Core Manufacturing Process** | Industrial scale low-cost manufacturing process | **Roll-to-Roll Manufacturing** (not batch processing) |
| **Semiconductor Absorber Layer** | Abundant supply<br><br>Positive environmental profile | **Amorphous Silicon**<br><br>(After extensive evaluation, PowerFilm eliminated the Copper Indium Gallium Selenide (CIGS) semiconductor absorber layer option out of concerns regarding the economic viability of CIGS technology at industrial scale, given the limited world supply of Indium and competition for that supply from the flat panel display industry. The materials costs for CIGS solar panels are currently high and potentially going to become extremely high cost. CIGS has some manufacturing wastes that are negative from an environmental standpoint. |
| **Cell Connection Technology** | Low cost and durable cell connection process | **Printed Interconnect** |
| **Substrate** | To work with printed interconnect and to be lightweight and flexible | **Flexible Plastic Substrate** |

# Financial Results

Revenue of $10,289,380 was realized for the year ended 31 December 2010, compared with $6,590,213 for the year ended 31 December 2009; a 56% increase.

Gross Margin for the year ended 31 December 2010 was 9.7%, compared with -5.0% for the year ended 31 December 2009.

Net loss was $631,326 for the year ended 31 December 2010, compared with a net loss of $1,851,926 for the year ended 31 December 2009; a 65.9% improvement over prior year.

The Company's balance sheet as at 31 December 2010, includes cash and cash equivalents of $3,890,121, restricted cash of $6,002,620, and cash and short-term investments (certificates of deposit with original maturities greater than three months) held for property and equipment construction of $8,100,000. These accounts total $17,992,741 at 31 December 2010, compared to a total of $17,278,812 at 31 December 2009. The cash and short-term investments held for property and equipment construction are not restricted funds, but rather an internal account for tracking of estimated amount of cash and short-term investments that will be used for construction of equipment. The $6,002,620 of restricted funds is in an interest bearing account contractually required to be maintained as a compensating balance at the bank that issued the letter of credit on the industrial revenue bonds.

In 2010 there was positive cashflow provided by operating activities in the amount of $1.7 million, which was driven by the reduced loss and a reduction in inventory levels.

The Company has significant development contracts in place that support the majority of the research and development, thus reducing internally funded research and development. Internal research and development for 2010 was $5,307, compared to $105,100 for 2009. The decrease in internal research and development in 2010 over 2009 was due to two additional development contracts in 2010. Selling, general, and administrative expenses were $2,061,171 in 2010, compared to $2,321,262 for 2009. This is an 11.2% reduction in SG&A from 2009 to 2010.

Interest and dividend income for the year ended 31 December 2010, was $181,481, compared to $128,043 for the previous year. The Company's policy is to place its cash and short-term investments with high credit quality financial institutions in order to limit the amount of credit exposure. Although, globally interest rates still are at a very low level, the increase in interest and dividend income is due to the Company increasing investments in higher yielding, secure certificates of deposit.

## Related Party Transactions

As was disclosed at the time of the initial public offering in the AIM Admission document, PowerFilm's Co-Founder and CEO Frank Jeffrey, a related party, leases his industrial building to PowerFilm, Inc. The 2010 annual lease amount was $90,000. The lease currently extends to January 1, 2014, with a renewal option.

# Financial Results - cont.

## 2010 Board of Directors' Remuneration

The 2010 remuneration for the PowerFilm, Inc., Board of Directors is presented in the table below.

| Director Name | Compensation in USD | # of Shares received | Value of shares in USD |
|---|---|---|---|
| Merlin Hanson | $27,916.65 | 24,570 | $8,227.45 |
| David Lindop | $0 | 96,400 | $36,245.73 |
| Frank Jeffrey * | $131,000 | | |
| Derrick Grimmer ** | $7,050 | | |

**Frank Jeffrey received no board compensation beyond his compensation of $131,000 as CEO
**Derrick Grimmer served as director for six months of 2010

## Accounts Audited

The financial information in this announcement is from the Company's audited accounts for the years ended 31 December 2010 and 2009. The Company's complete financial statements and footnotes will be included in the Company's annual report and will be available upon request.

The information presented herein has been prepared on the basis of current U.S. generally accepted accounting principles (US GAAP).

# Independent Auditor's Report

McGladrey & Pullen
Certified Public Accountants

## Independent Auditor's Report

The Board of Directors and Stockholders
PowerFilm, Inc.

We have audited the accompanying consolidated balance sheets of PowerFilm, Inc. and subsidiary as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity, comprehensive (loss) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PowerFilm, Inc. and subsidiary as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

McGladrey & Pullen, LLP

Des Moines, Iowa
March 22, 2011

# PowerFilm, Inc. and Subsidiary Consolidated Balance Sheets

## 31 December 2010 and 2009

| | **31-Dec-10** | 31-Dec-09 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents, net of cash held for property and equipment construction and restricted cash | **$3,890,121** | $8,448,812 |
| Accounts receivable, less allowance for doubtful accounts 2010, $37,800; 2009, $6,000 | **1,254,396** | 1,164,874 |
| Inventories | **2,761,979** | 3,294,266 |
| Prepaid expenses and other assets | **216,121** | 116,666 |
| Income tax receivable | **6,100** | 1,090,000 |
| Deferred income taxes | **836,000** | 237,000 |
| **Total current assets** | **8,964,717** | 14,351,618 |
| RESTRICTED CASH | **6,002,620** | - |
| CASH AND SHORT-TERM INVESTMENTS HELD FOR PROPERTY AND EQUIPMENT CONSTRUCTION | **8,100,000** | 8,830,000 |
| PROPERTY AND EQUIPMENT | | |
| Land | **972,432** | 972,432 |
| Building and improvements | **5,059,825** | 5,059,825 |
| Machinery and equipment | **8,760,689** | 8,361,317 |
| Leasehold improvements | **272,276** | 272,276 |
| Construction in progress | **5,198,382** | 4,833,835 |
| | **20,263,604** | 19,499,685 |
| Less accumulated depreciation | **(4,068,633)** | (3,101,060) |
| | **16,194,971** | 16,398,625 |
| OTHER ASSETS | **184,718** | 176,625 |
| | **$39,447,026** | $39,756,868 |

See Notes to Consolidated Financial Statements

## PowerFilm, Inc. and Subsidiary Liabilities and Stockholders' Equity

### 31 December 2010 and 2009

| | **31-Dec-10** | 31-Dec-09 |
|---|---|---|
| CURRENT LIABILITIES | | |
| Current maturities of long-term debt | **$250,000** | $4,625,000 |
| Trade accounts payable | **322,168** | 328,519 |
| Other payables and accrued expenses | **536,671** | 389,842 |
| Derivative financial instrument, interest rate swap | **-** | 341,294 |
| **Total current liabilities** | **1,108,839** | 5,684,655 |
| LONG-TERM LIABILITIES | | |
| Revenue bonds payable, less current maturities | **4,125,000** | - |
| Derivative financial instrument, interest rate swap | **461,731** | - |
| Deferred income taxes | **998,000** | 787,000 |
| **Total long-term liabilities** | **5,584,731** | 787,000 |
| COMMITMENTS | | |
| STOCKHOLDERS' EQUITY | | |
| Common stock | **380,622** | 376,661 |
| Additional paid-in capital | **32,623,603** | 32,475,649 |
| Retained earnings | **511,740** | 1,143,066 |
| Treasury stock, at cost | **(461,533)** | (488,675) |
| Accumulated other comprehensive (loss) | **(304,742)** | (225,254) |
| **Total PowerFilm Inc. and Subsidiary stockholders' equity** | **32,749,690** | 33,281,447 |
| Noncontrolling interest | **3,766** | 3,766 |
| **Total stockholders' equity** | **32,753,456** | 33,285,213 |
| | **$39,447,026** | $39,756,868 |

# PowerFilm, Inc. and Subsidiary Consolidated Statements of Operations

## 31 December 2010 and 2009

| | **31-Dec-10** | 31-Dec-09 |
|---|---|---|
| Operating revenues: | | |
| Sales | **$7,370,840** | $4,302,580 |
| Development contracts | **2,918,540** | 2,287,633 |
| | **10,289,380** | 6,590,213 |
| Cost of revenues | **9,288,101** | 6,925,345 |
| **Gross profit (loss)** | **1,001,279** | (335,132) |
| Operating expenses: | | |
| Research and development | **5,307** | 105,100 |
| Selling, general, and administrative | **2,061,171** | 2,321,262 |
| | **2,066,478** | 2,426,362 |
| **Operating (loss)** | **(1,065,199)** | (2,761,464) |
| Other income (expense): | | |
| Interest and dividend income | **181,481** | 128,043 |
| Interest (expense) | **(101,901)** | (63,124) |
| Other income (expense) | **(55,707)** | (48,351) |
| | **23,873** | 16,568 |
| **(Loss) before income tax (benefit)** | **(1,041,326)** | (2,744,926) |
| Income tax (benefit) | **(410,100)** | (893,000) |
| **Net (loss)** | **(631,326)** | (1,851,926) |
| Less: Net income (loss) attributable to the noncontrolling interest | **-** | **-** |
| **Net (loss) attributable to PowerFilm, Inc. and Subsidiary** | **$(631,326)** | $(1,851,926) |
| Basic (loss) per share | **$(0.02)** | $(0.05) |
| Diluted (loss) per share | **$(0.02)** | $(0.05) |

See Notes to Consolidated Financial Statements

## PowerFilm, Inc. and Subsidiary Consolidated Statements of Stockholders' Equity

### 31 December 2010 and 2009

| | Common Stock U.S. $ | Additional Paid-In Capital U.S. $ | Retained Earnings U.S. $ | Treasury Stock U.S. $ | Accumulated Other Comprehensive (Loss) U.S. $ | Noncontrolling Interest U.S. $ | **Total Equity** U.S. $ |
|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2008** | **$ 373,717** | **$32,329,012** | **$ 2,994,992** | **$ (144,591)** | **$ (500,224)** | **$ 3,766** | **$ 35,056,672** |
| Net (loss) | - | - | (1,851,926) | - | - | - | **(1,851,926)** |
| Unrealized derivative gain, net of tax expense of $141,000 | - | - | - | - | 274,970 | - | **274,970** |
| 288,300 restricted shares awarded from treasury shares, net of forfeitures | - | (125,640) | - | 125,640 | - | - | **-** |
| Stock awards exercised for 193,929 common shares | 1,939 | 14,061 | - | - | - | - | **16,000** |
| Acquisition of 1,769,000 shares for the treasury | - | - | - | (469,724) | - | - | **(469,724)** |
| Stock-based compensation expense, including tax benefit of $8,000 | - | 209,304 | - | - | - | - | **209,304** |
| Issuance of 100,476 common shares, including 3,437 committed shares to be issued from 2008 to directors as compensation, less tax expense of $23,000 | 1,005 | 43,495 | - | - | - | - | **44,500** |
| 13,309 committed shares to be issued | - | 5,417 | - | - | - | - | **5,417** |
| **Balance, December 31, 2009** | **376,661** | **32,475,649** | **1,143,066** | **(488,675)** | **(225,254)** | **3,766** | **33,285,213** |
| Net (loss) | - | - | (631,326) | - | - | - | **(631,326)** |
| Unrealized derivative (loss), net of tax benefit of $41,000 | - | - | - | - | (79,488) | - | **(79,488)** |
| Stock awards exercised for 275,139 common shares | 2,751 | 15,948 | - | - | - | - | **18,699** |
| 93,700 restricted shares awarded from treasury shares, net of forfeitures | - | (27,142) | - | 27,142 | - | - | **-** |
| Stock-based compensation expense, less tax expense of $4,000 | - | 114,065 | - | - | - | - | **114,065** |
| Issuance of 120,971 common shares, including 5,417 committed shares to be issued from 2009 to directors as compensation, less tax expense of $2,000 | 1,210 | 43,000 | - | - | - | - | **44,210** |
| 6,853 committed shares to be issued | - | 2,083 | - | - | - | - | **2,083** |
| **Balance, December 31, 2010** | **$ 380,622** | **$32,623,603** | **$ 511,740** | **$ (461,533)** | **$ (304,742)** | **$ 3,766** | **$ 32,753,456** |

See Notes to Consolidated Financial Statements

# PowerFilm, Inc. and Subsidiary Consolidated Statements of Comprehensive (Loss)

## 31 December 2010 and 2009

| | **31-Dec-10** | 31-Dec-09 |
|---|---|---|
| Net (loss) | **$(631,326)** | $(1,851,926) |
| Other comprehensive income (loss), unrealized derivative gain (loss), net of tax | **(79,488)** | 274,970 |
| **Comprehensive (loss)** | **(710,814)** | (1,576,956) |
| Comprehensive income (loss) attributable to the noncontrolling interest | **-** | **-** |
| **Comprehensive (loss) attributable to PowerFilm, Inc. and Subsidiary** | **$(710,814)** | $(1,576,956) |

See Notes to Consolidated Financial Statements

# PowerFilm, Inc. and Subsidiary Consolidated Statements of Cash Flows

## 31 December 2010 and 2009

| | **31-Dec-10** | 31-Dec-09 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net (Loss) | **$(631,326)** | $(1,851,926) |
| Adjustments to reconcile net (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | **992,946** | 1,016,745 |
| Provision for doubtful accounts | **37,800** | 16,950 |
| Deferred taxes | **(347,000)** | 422,000 |
| Stock-based compensation expense | **160,307** | 251,221 |
| Tax benefit resulting from stock awards | **-** | 8,000 |
| Changes in working capital components: | | |
| Accounts receivable | **(127,322)** | 375,441 |
| Inventories | **532,287** | (819,415) |
| Prepaid expenses and other assets | **(99,455)** | 6,263 |
| Income tax receivable | **1,083,900** | (987,000) |
| Trade accounts payable | **(6,351)** | (185,588) |
| Other payables and accrued expenses | **146,829** | (234,520) |
| **Net cash provided by (used in) operating activities** | **1,742,615** | (1,981,829) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of property and equipment | **(763,920)** | (3,338,080) |
| Decrease in cash and short-term investments held for property and equipment construction | **730,000** | 2,900,000 |
| (Increase) in restricted cash | **(6,002,620)** | - |
| (Increase) in other assets | **(33,465)** | (11,900) |
| **Net cash (used in) investing activities** | **(6,070,005)** | (449,980) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Principal payments on long-term debt | **(250,000)** | (250,000) |
| Acquisition of treasury stock | **-** | (469,724) |
| Proceeds from issuance of common stock, net | **18,699** | 16,000 |
| **Net cash (used in) financing activities** | **(231,301)** | (703,724) |
| **Net (decrease) in cash and cash equivalents** | **(4,558,691)** | (3,135,533) |
| CASH AND CASH EQUIVALENTS | | |
| Beginning | **8,448,812** | 11,584,345 |
| Ending | **$3,890,121** | $8,448,812 |

*(Continued on next page)*

## PowerFilm, Inc. and Subsidiary Consolidated Statements of Cash Flows – cont.

### 31 December 2010 and 2009

| | **31-Dec-10** | 31-Dec-09 |
|---|---|---|
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION, CASH PAYMENTS (RECEIPTS) FOR: | | |
| Interest | **$261,473** | $189,074 |
| Income taxes | **(1,142,000)** | (610,000) |
| SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES | | |
| Gain (loss) on interest rate swap agreement | **$(79,488)** | $274,970 |
| Restricted shares awarded from treasury shares | **27,142** | 125,640 |

See Notes to Consolidated Financial Statements

## PowerFilm, Inc. and Subsidiary Notes to Consolidated Financial Statements

### Note 1. Summary of Significant Accounting Policies

Nature of business: PowerFilm, Inc. was incorporated on October 13, 1988, for the purpose of research and development of thin film technologies. PowerFilm, Inc.'s focus is now the use of such developed technologies to manufacture solar modules. PowerFilm, Inc. sells its solar modules throughout the world and continues to enter into research contracts to further develop the thin film technology for use in the manufacturing of solar cells. Phicot, Inc. was incorporated as a subsidiary during 2008 for the purpose of conducting further research and development under these research contracts.

Principles of consolidation: The consolidated financial statements include the accounts of PowerFilm, Inc. and its 92% owned subsidiary, Phicot, Inc. (collectively, the Company). All intercompany balances and transactions have been eliminated in consolidation.

Use of estimates: The preparation of consolidated 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair value measurements: The Company measures fair value of financial instruments in accordance with the *Fair Value Measurements and Disclosures* topic of the Accounting Standards Codification. In general, fair value measurements are based upon quoted market prices, where available. If quoted market prices are not available, fair value measurements are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and require some degree of judgment regarding interest rates, credit risk, prepayments, and other factors. The use of different assumptions or estimation techniques may have a significant effect on the fair value amounts reported.

Cash and cash equivalents: The Company considers all cash accounts which are not subject to restrictions, and all highly liquid investments with an original maturity of three months or less, to be cash equivalents. At December 31, 2010 and 2009, approximately $232,000 and $80,000, respectively, of cash is denominated in a foreign currency. During the years ended December 31, 2010 and 2009, approximately ($56,000) of foreign currency (loss) and $62,000 of foreign currency gain, respectively, were recognized in other income (expense) on the consolidated statements of operations.

Short-term investments: Short-term investments are recorded at cost and consist of certificates of deposit with maturities at date of purchase of more than three months. As of December 31, 2010, $3,800,000 of the certificates of deposit are in United States banks and are fully insured by the FDIC, with maturities from April 2011 through September 2011. The remaining certificate of deposit totaling approximately $500,000 is with a bank in the United Kingdom and matures in September 2011. The United Kingdom certificate is denominated in British Pounds, with 50,000 British Pounds guaranteed by the United Kingdom Deposit Protection program. Interest income on these certificates is recorded on the accrual basis.

Accounts receivable: Accounts receivable are carried at original invoice amount less an estimate for doubtful receivables based on a review of outstanding amounts. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Inventories: Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out (FIFO) basis.

Property and equipment: Property and equipment is recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the related assets. During 2010 and 2009, the Company capitalized interest totaling approximately $158,000 and $128,000, respectively, related to construction in progress.

Revenue recognition: Revenue from product sales is recognized upon shipment of the product to the customer. Revenue from development contracts is recognized as services are performed. Shipping and handling charges to customers are included in operating revenue. Shipping and handling costs incurred by the Company are included in cost of revenues.

Foreign sales: During the years ended December 31, 2010 and 2009, sales to customers located in foreign countries (primarily Hong Kong and China) totaled approximately $2,300,000 and $958,000, respectively.

## PowerFilm, Inc. and Subsidiary Notes to Consolidated Financial Statements – cont.

Concentration of credit risk: The Company's financial instruments that are subject to concentrations of credit risk consist primarily of cash, short-term investments and accounts receivable. The Company's policy is to place its cash and short-term investments with high credit quality financial institutions in order to limit the amount of credit exposure. The Company maintains cash in bank accounts and certificates of deposit that at times may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Restricted cash: Amount is restricted in accordance with compensating balance agreement discussed in Note 3.

Cash and short-term investments held for equipment construction: The estimated amount of cash and short-term investments that will be used for construction of equipment has been classified as long term according to its estimated use.

(Loss) per share: Basic (loss) per share is calculated by dividing net (loss) by the weighted average number of common shares outstanding during the period. Diluted (loss) per share is calculated by dividing net (loss) by the weighted average number of common shares and potential common shares outstanding during the period.

Stock-based compensation: Compensation cost for all stock-based awards is measured at fair value on the date of grant and recognition of compensation expense over the requisite service period for awards expected to vest. The Company's consolidated statements of operations include stock-based compensation expense of approximately $160,000 and $251,000 for the years ended December 31, 2010 and 2009, respectively.

Income taxes: Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss, and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management has determined that it is more likely than not that deferred tax assets will be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Company may recognize the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest, and penalties on income taxes, and accounting in interim periods. The Company has evaluated their material tax positions and determined no effects on the financial statements related to uncertainty to income taxes. In general the Company is no longer subject to federal and state examinations by tax authorities for years before 2007. The Internal Revenue Service (IRS) has examined the Company's U.S. federal income tax returns for 2007 and 2009 and those years are effectively closed for the federal tax jurisdiction.

Derivative financial instruments: The Company has adopted hedge accounting for an interest rate swap contract in connection with borrowings on variable rate long-term debt. The swap is utilized to manage variable interest rate exposure and on the date the contract was entered into, the Company designated the derivative as a hedge of the variability of cash flows to be received or paid related to a recognized liability ("cash flow" hedge). Changes in the fair value of a derivative that are highly effective and that are designated and qualify as a cash flow hedge are recorded in other comprehensive income (loss) until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate liability are recorded in earnings).

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as cash flow hedges to specific liabilities on the balance sheet. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively. No ineffectiveness was recognized on the interest rate swap for the year ended December 31, 2010.

At December 31, 2010, management's expectation is that no significant amounts in 2010 accumulated other comprehensive (loss) will be reclassified to earnings during the next 12 months.

The fair value of the interest rate swap was a liability of approximately $462,000 and $341,000 at December 31, 2010 and 2009, respectively. The notional amount of the interest rate swap at December 31, 2010, is $4,375,000 and the interest rate swap agreement expires June 1, 2028. Under the swap agreement, the Company pays interest at a fixed rate of 3.6% and receives interest at a variable rate equal to 70% of one-month LIBOR (approximately 0.18% at December 31, 2010). The interest rate swap liability was classified as a current liability in the consolidated balance sheets as of December 31, 2009 due to the covenant violations discussed in Note 3. As of December 31, 2010, the covenants are no longer in violation and accordingly the liability has been classified as long-term in the consolidated balance sheets as of December 31, 2010, in accordance with the contractual term of the agreement.

Other comprehensive income: Other comprehensive income consists of the effective portion of net gains or losses on derivative instruments designated as qualifying cash flow hedges.

Operating segment: The Company uses the "management approach" for reporting information in financial statements. The management approach is based on the way the chief operating decision maker organizes segments within a company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure, and any other manner in which management disaggregates a company. Based on the management approach model, the Company has determined that its business is comprised of a single operating segment.

## Note 2. Inventories

Inventories were composed of the following at December 31:

| | **2010** | 2009 |
|---|---|---|
| Raw materials | **$1,165,704** | $993,987 |
| Work in process | **879,324** | 1,424,883 |
| Finished products | **716,951** | 875,396 |
| | **$2,761,979** | $3,294,266 |

## Note 3. Revenue Bonds Payable

The Company has $4,375,000 tax exempt industrial revenue bond issued by the Iowa Finance Authority. Interest payments, at a variable interest rate calculated weekly based on adjustable rates, are due monthly. Principal payments of $125,000 are due June 1 and December 1 of each year through June 1, 2028, when all remaining principal and interest are due. Future bond maturities as of December 31, 2010, total $250,000 for each of the years ending 2011, 2012, 2013, 2014, and 2015 and $3,125,000 thereafter.

The Bonds are secured by a first lien on real estate, including improvements thereon, together with the machinery and equipment purchased with the proceeds of the bond issue. Proceeds from the bond were restricted for use in construction of a new facility and all of the proceeds have been used for the new facility; therefore, no restriction remains on the balance sheet. To provide additional security for payment, the Company is required to maintain a letter of credit agreement with a bank in the amount of the outstanding principal and interest payable on the related bonds. No amounts are outstanding on the letter of credit as of December 31, 2010 or 2009.

In connection with the bond agreement and letter of credit, the Company was previously required to maintain certain financial covenants. At December 31, 2009, the Company was in violation of these financial covenants which constituted an event of default under the terms of the bond agreement. Due to the event of default at the end of 2009, the Iowa Finance Authority had the ability to demand payment of the entire outstanding balance at any time. Accordingly, the outstanding balances of the bond and interest rate swap were classified as a current liability at December 31, 2009.

## PowerFilm, Inc. and Subsidiary Notes to Consolidated Financial Statements – cont.

During 2010, the bond agreement and letter of credit were amended to remove the financial covenants in return for the Company maintaining a compensating balance equal to $6 million in a deposit account at the bank which issued the letter of credit. The compensating balance has been maintained as of December 31, 2010, and accordingly, the outstanding balances of the bond and interest rate swap not contractually due in the next 12 months have been classified as long term liabilities as of December 31, 2010.

### Note 4. Income Taxes

Income tax (benefit) consists of the following for the years ended December 31, 2010 and 2009:

| | **2010** | 2009 |
|---|---|---|
| Current (benefit) | **$(63,000)** | $(1,315,000) |
| Deferred expense (benefit) | **(347,000)** | 422,000 |
| | **$(410,000)** | $(893,000) |

Income tax (benefit) differs from the amount expected by applying the statutory federal tax rate to income before taxes as a result of the following:

| | **2010** | 2009 |
|---|---|---|
| Tax (benefit) at the statutory tax rate | **$(354,000)** | $(934,000) |
| Increase in tax resulting from: | | |
| Tax credit carryforward | **(51,000)** | 33,000 |
| Other, net | **(5,000)** | 8,000 |
| **Tax (benefit) at effective tax rate** | **$(410,000)** | $(893,000) |

## PowerFilm, Inc. and Subsidiary Notes to Consolidated Financial Statements – cont.

The tax effects of significant items comprising the Company's net deferred tax assets (liabilities) as of December 31, 2010 and 2009 are as follows:

| | **2010** | 2009 |
|---|---|---|
| Deferred tax assets: | | |
| Interest rate swap agreements | **$157,000** | $116,000 |
| Restricted stock grants | **47,000** | 24,000 |
| Accrued expenses | **70,000** | 59,000 |
| Foreign currency | **36,000** | 59,000 |
| Tax credit carryforward | **78,000** | - |
| Net operating loss carryforward | **434,000** | - |
| Other | **14,000** | 3,000 |
| | **836,000** | 261,000 |
| Deferred tax liabilities: | | |
| Property and equipment | **(998,000)** | (811,000) |
| **Net deferred tax (liabilities)** | **$(162,000)** | $(550,000) |

As of December 31, 2010, the Company has unused net operating loss carryforwards of approximately $1,275,000, which expire in 2030.

### Note 5. Leases

The Company leases its offices and manufacturing facility from a stockholder under a five-year operating lease that runs through January 1, 2014, with monthly lease payments of $7,500. Rent expense under this lease totaled $90,000 for each of the years ended December 31, 2010 and 2009.

### Note 6. 401(k) Plan

The Company has a 401(k) profit sharing plan which covers substantially all employees of the Company. The Company may make annual contributions to the plan at the discretion of the Board of Directors. The Company contributed approximately $257,000 and $153,000 during the years ended December 31, 2010 and 2009, respectively.

## Note 7. Major Customers

Net sales for the years ended December 31, 2010 and 2009 include sales to the following major customers, together with the approximate accounts receivable due from those customers:

| | Net Sales | | Accounts Receivable | |
|---|---|---|---|---|
| | December 31, | | December 31, | |
| | **2010** | 2009 | **2010** | 2009 |
| Customer A | **27%** | 37% | **$243,000** | $654,000 |
| Customer B* | **13%** | 4% | **-** | - |

*These sales are to customers located in foreign countries.

## Note 8. Components of Common Stock

Information regarding components of $0.01 par value common stock at December 31, 2010 and 2009 is as follows:

| | Authorized Shares | Issued Shares | Outstanding Shares | Committed to be Issued Shares |
|---|---|---|---|---|
| **2010** | **60,000,000** | **38,062,209** | **36,418,009** | **6,853** |
| 2009 | 60,000,000 | 37,666,099 | 35,928,199 | 13,309 |

During the years ended December 31, 2010 and 2009 the Company acquired none and 1,769,000 treasury shares at a cost of approximately zero and $470,000, respectively. An additional 9,800 and 36,700 shares previously issued under the restricted stock plans discussed in Note 10 were forfeited during 2010 and 2009, respectively, prior to vesting. Per the terms of the restricted stock plan, these shares are to be held in treasury and are available for future grant under the plans. During 2010, the Company granted 75,000 and 28,500 restricted shares under the 2010 and 2009 restricted stock plans respectively as discussed in Note 10.

As of December 31, 2010, there were 150,049 issued shares held in an escrow account subject to certain restrictions as discussed in Note 10.

## Note 9. Commitments

The Company has historically entered into research and development contracts, for further development of the Company's technology, which are funded directly and indirectly through governmental agencies. The contract terms range from actual cost to cost plus a fixed fee. Revenue is earned as cost is incurred. Costs and any related fees included under such contracts are billed monthly for the costs incurred for the current month ending.

As of December 31, 2010, the Company had future research and development contractual commitments of approximately $2,272,000.

## Note 10. Stock-Based Compensation

### 2005 Plan

The Company's Board of Directors adopted the 2005 Incentive Stock Option Plan (2005 Plan) during October 2005. Under the 2005 Plan, options may be granted to officers, directors, and employees to purchase up to an aggregate of 3,030,150 shares of the Company's common stock. Option awards are granted with an exercise price equal to the market price of the Company's stock at the date of grant. Under the 2005 Plan, the term of the options may not exceed ten years. Incentive stock options granted under the 2005 Plan vest 20% immediately and then 20% annually thereafter for the following four years. At December 31, 2010, there were 339,383 common shares available for future grant under the 2005 Plan. No option awards were granted during the years ended December 31, 2010 and 2009.

The following table summarizes stock option activity for the year ended December 31, 2010:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term |
|---|---|---|---|
| Outstanding options, December 31, 2009 | 1,079,571 | $0.84 | |
| Exercised | (275,139) | 0.08 | |
| Forfeited | (11,660) | 2.40 | |
| Outstanding options, December 31, 2010 | 792,772 | $1.04 | 5 years |
| Exercisable at December 31, 2010 | 792,772 | $1.04 | 5 years |

The intrinsic value of options exercised during the years ended December 31, 2010 and 2009 totaled approximately $533,000 and $62,000, respectively.

Cash received for option exercises for the years ended December 31, 2010 and 2009 totaled $19,000 and $16,000, respectively.

As of December 31, 2010, all options were fully vested with no future compensation expense to be recognized.

## 2007 Plan

The Company's Board of Directors adopted the 2007 Restricted Stock Plan (2007 Plan) during October 2007. Under the 2007 Plan, restricted shares may be granted to any full-time employee of the Company, except officers and directors. Common shares issued under the 2007 Plan may not be sold or otherwise transferred until restrictions have lapsed. During the vesting period, participants have voting rights and receive dividends on the restricted shares. The 2007 Plan authorized a total of 100,000 shares to be available for grant. Awards that are forfeited prior to vesting are held in treasury and are available for future grant. At December 31, 2010, there were 55,200 common shares available for future grant under the 2007 Plan. There were no share awards granted under the 2007 Plan during the year ended December 31, 2010 and 2009.

The following table presents information regarding the Company's 2007 restricted stock plan as of December 31, 2010:

| | Number of Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Restricted stock, beginning of year | 18,508 | $4.20 |
| Vested | (7,234) | 4.20 |
| Forfeited | (3,000) | 4.20 |
| Restricted stock, end of year | 8,274 | $4.20 |

As of December 31, 2010, unrecognized compensation cost for the 2007 plan totaled approximately $35,000, which is expected to be recognized over a weighted average remaining period of 1.7 years.

## 2009 Plan

The Company's Board of Directors adopted the 2009 Restricted Stock Plan (2009 Plan) during January 2009. Under the 2009 Plan, restricted shares may be granted to any full-time employee of the Company, except officers and directors. Common shares issued under the 2009 Plan may not be sold or otherwise transferred until restrictions have lapsed. During the vesting period, participants have voting rights and receive dividends on the restricted shares. The 2009 Plan authorized a total of 325,000 shares to be available for grant. Awards that are forfeited prior to vesting are held in treasury and are available for future grant. At December 31, 2010, there were 1,500 shares available for future grant under the 2009 Plan.

The following table presents information regarding the Company's 2009 restricted stock plan as of December 31, 2010:

| | Number of Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Restricted stock, beginning of year | 111,300 | $0.36 |
| Granted | 28,500 | - |
| Vested | (47,475) | - |
| Forfeited | (6,800) | - |
| Restricted stock, end of year | 85,525 | $0.38 |

As of December 31, 2010, unrecognized compensation cost for restricted stock totaled approximately $33,000, which is expected to be recognized over a weighted average remaining period of 2.2 years.

### 2010 Plan

The Company's Board of Directors adopted the 2010 Restricted Stock Plan (2010 Plan) during November 2010. Under the 2010 Plan 75,000 restricted shares were granted to one individual. Common shares issued under the 2010 Plan may not be sold or otherwise transferred until restrictions have lapsed. The grant date fair value was $0.34 per share. 18,750 of the shares are vested as of December 31, 2010. Unrecognized compensation cost of approximately $19,000 related to the 56,250 remaining unvested shares as of December 31, 2010, will be recognized over the remaining two year vesting period. During the vesting period, the participant has voting rights and receives dividends on the restricted shares. No further shares are available for future grant under the 2010 Plan.

The fair value of restricted stock awards, based on the fair value of the Company's common stock on the date of grant, is being amortized as compensation expense on a straight-line basis over the period the restrictions lapse. Compensation expense related to restricted share awards issued under the 2007, 2009 and 2010 Plans totaling approximately $55,000 and $105,000 is included in selling, general and administrative expenses on the consolidated statements of operations for the years ended December 31, 2010 and 2009, respectively.

## Note 11. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2010 and 2009:

| | **2010** | 2009 |
|---|---|---|
| Net income (loss), basic and diluted, attributable to PowerFilm, Inc. and Subsidiary | **$(631,326)** | $(1,851,926) |
| Average outstanding shares - basic | **36,253,355** | 36,572,467 |
| Add: effect of dilutive stock options | **-** | - |
| Average outstanding shares - diluted | **36,253,355** | 36,572,467 |
| Basic earnings (loss) per share | **$(0.02)** | $(0.05) |
| Diluted earnings (loss) per share | **$(0.02)** | $(0.05) |

There were 942,821 and 1,209,379, for the years ended December 31, 2010 and 2009, respectively, of antidilutive stock options and restricted stock outstanding. Accordingly, the dilutive effect of these options and restricted shares has been excluded from the calculation of diluted earnings per share above.

## Note 12. Fair Value Measurements

The Company measures fair value in accordance with the Fair Value Measurements and Disclosures topic of the Accounting Standards Codification. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The accounting standard requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In this regard, the standard establishes a fair value hierarchy for valuation inputs that give the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2010 and 2009 are as follows:

| **2010**<br>**Description** | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
|---|---|---|---|---|
| **Liabilities, interest rate swap agreement** | **$461,731** | **$ -** | **$461,731** | **$ -** |

| 2009<br>Description | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Liabilities, interest rate swap agreement | $341,294 | $ - | $341,294 | $ - |

Interest rate swap agreement: The interest rate swap is valued using a discounted cash flow model that uses verifiable yield curve inputs to calculate the fair value and is classified within Level 2 of the valuation hierarchy. This method is not dependent on the input of any significant judgments for assumptions by management.

## PowerFilm, Inc. and Subsidiary Notes to Consolidated Financial Statements – cont.

Accounting standards also require disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. Fair value is determined under the framework established above. Certain financial instruments and all nonfinancial instruments are excluded from these disclosure requirements. The Company's financial instruments consist primarily of cash and cash equivalents, short-term investments, accounts receivable, trade accounts payable, revenue bonds payable and an interest rate swap. The carrying amounts of cash and cash equivalents, accounts receivable, and trade accounts payable approximate fair value due to the short maturities of those instruments. The carrying values of revenue bonds payable approximate fair values since they include variable interest rates which are not significantly different than current market rates. The fair value of the interest rate swap is estimated as described above. The fair value of short-term investments as of December 31, 2010, is approximately $4,336,000 estimated using market rates currently offered for certificates of deposit with similar remaining maturities.

### Note 13. Subsequent Events

Subsequent events have been evaluated for potential recognition and disclosure through March 22, 2011, the date the financial statements were issued. Through that date, there were no events requiring recognition or disclosure.

# Outlook

2011 is a pivotal year for PowerFilm to return to profitability, and then to grow net income consistently going forward. The foundation for profitability began with the Company's thorough evaluation of solar technology options, and its technology platform choices: roll-to-roll manufacturing (not batch), amorphous silicon (eliminated CIGS which the Company also evaluated), the use of the Company's proprietary printed interconnect for low-cost and durable cell connection, and the flexible plastic substrate. The foundation has been enhanced with technology improvements, especially the lower-cost meter-wide manufacturing equipment and downweb processing. Preliminary development of an even thinner substrate for larger panels indicates the potential to further reduce costs. Increased processing speeds present another opportunity for additional cost reductions. The third-party certification of our longer-life product for building integrated use will complete another important technology milestone. This technology foundation is in combination with our growing marketing and sales programs, strengthened market presence, and expanded commercial strategic relationships. Equally importantly, our industry-leading in-house engineering expertise is focused on customizing our products in a low-cost manner for large-volume, high-value applications. PowerFilm is an industry leader in mass customizing solar products, which gives the Company a strong basis for solving customer power needs.

Our OEM, solar chargers, and military products and market relationships are expected to generate strong increases in sales revenue and gross profit in 2011 and beyond. These sales will be augmented by our targeted approach in the building integrated market with our initial emphasis on the architectural fabric segment through our global strategic relationship with Ferrari Textiles. As we increase product volume, our capacity utilization will be optimized to further reduce costs.

This year we plan to achieve greater levels of sales and profits in both the OEM market – especially with solar panels for golf carts – and in military sales of foldable solar chargers and Powershade field shelters.

In the current dynamic global solar industry, PowerFilm has a competitive advantage in its ability to add production capacity incrementally according to confirmed market demand, and to add capacity with a capex cost that is highly competitive, with potential to be reduced further.

PowerFilm's manufacturing process and product profiles are strong environmentally (no cadmium, no tellurium) and strong from a safety perspective.

PowerFilm's majority-owned subsidiary Phicot, Inc., is very well placed to develop key technology for the flexible display industry, and is an additional growth platform of the Company.

PowerFilm has the firm foundation to deliver profits now and the potential to evolve into a solar industry profit leader.

# Forward-looking Statements

This release includes forward-looking statements which are based on certain assumptions and reflect management's current expectations as contemplated under the Safe Harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. Some of these factors include: uncertainty as to whether our strategies, partnerships, and business plans will yield the expected benefits; general global economic conditions; general industry and market conditions and growth rates; increasing competition; the ability to identify, develop, and achieve commercial success for new products, services and technologies; changes in technology; changes in laws and regulations, including government incentive programs; intellectual property rights; our ability to secure and maintain strategic relationships, including key supply relationships; the availability and cost of capital; the availability of, and our ability to retain, key personnel; and the failure of the Company to effectively integrate acquisitions. Additional factors are discussed in our public disclosure materials from time to time. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

## Mission Statement

PowerFilm was founded with the purpose of producing affordable solar and semiconductor solutions using its unique thin film proprietary technology. Our mission is to be the partner of choice for the world's leading providers, governments and enterprises by helping them create the most innovative, reliable and cost-effective solar and semiconductor devices. We will grow and become a market leader by consistently exceeding our Customer's expectations; providing them with the best of technology solutions for their specific needs.

To realize this mission, we will foster a corporate culture that attracts and retains creative, practical, and energetic employees who as a Team are driven to "make it happen."

## Vision Statement

PowerFilm, Inc. during the next five years will continue to develop unique solar solutions and thin film semiconductor devices on plastic utilizing its proprietary thin film, lightweight, and flexible core technology and grow its revenues beyond $100 million through strategic customer alignment, that results in providing solar power throughout the planet, universe, and beyond.

## Corporate Profile

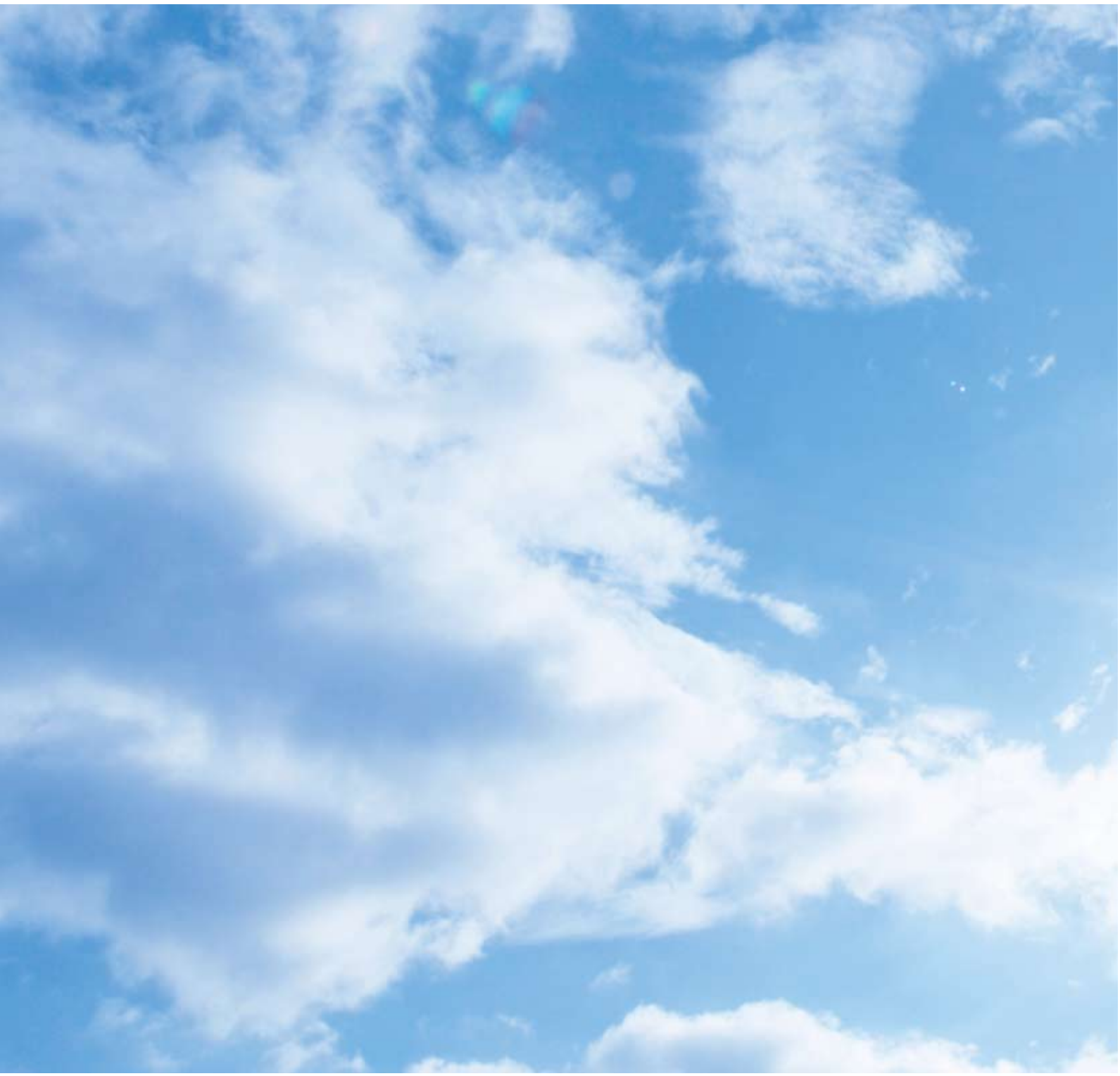
PowerFilm, Inc., founded in 1988 by Frank Jeffrey and Derrick Grimmer, is a leading global developer and manufacturer of thin, flexible solar panels. The company's proprietary low-cost manufacturing platform combines roll-to-roll manufacturing, a printed interconnect, amorphous silicon, and a flexible plastic substrate. PowerFilm's products are marketed and sold into the military, commercial/industrial, and consumer markets. The company plans to enter the building integrated solar market, integrating its low-profile panels with architectural fabric, metal roofing, and membrane roofing.

### Customer Service
We are focused on delivering reliability, dependability, fair prices, and exceptional service to our customers around the globe.

### Employee Commitment
We equip our employees with the resources and training they need to be successful. We encourage teamwork throughout the organization and provide a safe, rewarding environment.

### Financial Strength
We are excellent stewards of our financial resources. We invest in hard assets and focus on long-term opportunities that will contribute to the future strength of the company.

### Operational Excellence
Together with our employees, we pride ourselves on excellence in every aspect of our work, which allows us to meet and exceed our customers' expectations, perform our work safely, and preserve our assets.



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